



DEPARTMENT OF THE TREASURY

Financial Crimes Enforcement Network

31 CFR Parts 1010, 1020, 1023, 1024, and 1026

RIN 1506-AB25

Customer Due Diligence Requirements for Financial Institutions

AGENCY: Financial Crimes Enforcement Network (FinCEN), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Financial Crimes Enforcement Network (FinCEN), after consulting with staff from various federal supervisory authorities, is proposing rules under the Bank Secrecy Act to clarify and strengthen customer due diligence requirements for: banks; brokers or dealers in securities; mutual funds; and futures commission merchants and introducing brokers in commodities. The proposed rules would contain explicit customer due diligence requirements and would include a new regulatory requirement to identify beneficial owners of legal entity customers, subject to certain exemptions.

DATES: Written comments on the Notice of Proposed Rulemaking (NPRM) must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Comments may be submitted, identified by Regulatory Identification Number (RIN) 1506-AB25, by any of the following methods:

- Federal E-rulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments. Include RIN 1506-AB25 in the submission. Refer to Docket Number FINCEN-2014-0001.

• Mail: Policy Division, Financial Crimes Enforcement Network, P.O. Box 39, Vienna, VA 22183. Include 1506–AB25 in the body of the text. Please submit comments by one method only. All comments submitted in response to this NPRM will become a matter of public record. Therefore, you should submit only information that you wish to make publicly available.

Inspection of comments: Comments may be inspected, between 10 a.m. and 4 p.m., in the FinCEN reading room in Vienna, VA. Persons wishing to inspect the comments submitted must request an appointment with the Disclosure Officer by telephoning (703) 905–5034 (not a toll free call). In general, FinCEN will make all comments publicly available by posting them on <http://www.regulations.gov>.

FOR FURTHER INFORMATION CONTACT: FinCEN Resource Center at 1-800-767-2825 or 1-703-905-3591 (not a toll free number) and select option 3 for regulatory questions. E-mail inquiries can be sent to FRC@fincen.gov.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

FinCEN exercises regulatory functions primarily under the Currency and Foreign Transactions Reporting Act of 1970, as amended by the USA PATRIOT Act of 2001 (PATRIOT Act) and other legislation, which legislative framework is commonly referred to as the “Bank Secrecy Act” (BSA).¹ The BSA authorizes the Secretary of the Treasury (Secretary) to require financial institutions to keep records and file reports that “have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or

¹ The BSA is codified at 12 U.S.C. 1829b, 12 U.S.C. 1951–1959, 18 U.S.C. 1956, 1957, and 1960, and 31 U.S.C. 5311–5314 and 5316–5332 and notes thereto, with implementing regulations at 31 CFR chapter X. See 31 CFR 1010.100(e).

in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.”²

The Secretary has delegated to the Director of FinCEN the authority to implement, administer and enforce compliance with the BSA and associated regulations.³ FinCEN is authorized to impose anti-money laundering (AML) program requirements on financial institutions,⁴ as well as to require financial institutions to maintain procedures to ensure compliance with the BSA and the regulations promulgated thereunder or to guard against money laundering.⁵

FinCEN, in consultation with the staffs of the federal functional regulators and the Department of Justice, has determined that more explicit rules for covered financial institutions⁶ with respect to customer due diligence (CDD) are necessary to clarify and strengthen CDD within the BSA regime. As demonstrated further below, such changes will enhance financial transparency and safeguard the financial system against illicit use. Requiring financial institutions to perform effective CDD so that they know their customers – both who they are and what transactions they conduct – is a critical aspect of combating all forms of illicit financial activity, from terrorist financing and sanctions evasion to more traditional financial crimes, including money laundering, fraud, and tax

² 31 U.S.C. 5311.

³ Treasury Order 180–01 (March 24, 2003).

⁴ 31 U.S.C. 5318(h)(2).

⁵ 31 U.S.C. 5318(a)(2).

⁶ For purposes of this preamble, a “covered financial institution” refers to: (i) banks; (ii) brokers or dealers in securities; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers in commodities.

evasion. For FinCEN, the key elements of CDD include: (i) identifying and verifying the identity of customers; (ii) identifying and verifying the identity of beneficial owners of legal entity customers (i.e., the natural persons who own or control legal entities); (iii) understanding the nature and purpose of customer relationships; and (iv) conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions. Collectively, these elements comprise the minimum standard of CDD, which FinCEN believes is fundamental to an effective AML program.

Accordingly, this Notice of Proposed Rulemaking (NPRM) proposes to amend FinCEN's existing rules so that each of these pillars is explicitly referenced in a corresponding requirement within FinCEN's program rules. The first element, identifying and verifying the identity of customers, is already included in the existing regulatory requirement to have a customer identification program (CIP). Given this fact, FinCEN is addressing the need to have explicit requirements with respect to the three remaining elements via two rule changes. First, FinCEN is addressing the need to collect beneficial owner information on the natural persons behind legal entities by proposing a new separate requirement to identify and verify the beneficial owners of legal entity customers, subject to certain exemptions. Second, FinCEN is proposing to add explicit CDD requirements with respect to understanding the nature and purpose of customer relationships and conducting ongoing monitoring as components in each covered financial institution's core AML program requirements. Within this context, FinCEN is also updating its regulations to include explicit reference to all four of the pre-existing core requirements of an AML program, sometimes referred to as "pillars," so that all of these requirements are visible within FinCEN's rules. As discussed in more detail below,

these existing core requirements are already laid out in the BSA as minimum requirements and are substantively the same as those already included within regulations or rules issued by federal functional regulatory agencies and self-regulatory organizations (SROs), and therefore we believe they do not add to or otherwise change the covered financial institutions' existing obligations under these regulations or rules.

FinCEN wishes to emphasize at the outset that nothing in this proposal is intended to lower, reduce, or limit the due diligence expectations of the federal functional regulators or in any way limit their existing regulatory discretion. To clarify this point, this proposal incorporates the CDD elements on nature and purpose and ongoing monitoring into FinCEN's existing AML program requirements, which generally provide that an AML program is adequate if, among other things, the program complies with the regulation of its federal functional regulator (or, where applicable, self-regulatory organization) governing such programs.⁷ In addition, the Treasury Department intends for the requirements contained in this customer due diligence and beneficial ownership proposal to be consistent with, and not to supersede, any regulations, guidance or authority of any federal banking agency, the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), or of any self-regulatory organization (SRO) relating to customer identification, including with respect to the verification of the identities of legal entity customers.

⁷ See, e.g., 31 CFR 1020.210, which currently provides that a financial institution regulated by a Federal functional regulator that is not subject to the regulations of a self-regulatory organization shall be deemed to satisfy the requirements of 31 U.S.C. 5318(h)(1) if it implements and maintains an anti-money laundering program that complies with *the regulation of its Federal functional regulator governing such programs*. (emphasis added).

The remainder of this background section provides: (a) an overview of the importance of CDD; (b) a description of the Advance Notice of Proposed Rulemaking (ANPRM⁸), which initiated this rulemaking process and Treasury's subsequent outreach to the private sector; and (c) an overview of Treasury's efforts to enhance financial transparency more broadly.

A. IMPORTANCE OF CUSTOMER DUE DILIGENCE

Clarifying and strengthening CDD requirements for U.S. financial institutions, including an obligation to identify beneficial owners, advances the purposes of the BSA by:

- Enhancing the availability to law enforcement, as well as to the federal functional regulators and SROs, of beneficial ownership information of legal entity customers obtained by U.S. financial institutions, which assists law enforcement financial investigations and regulatory examinations and investigations;
- Increasing the ability of financial institutions, law enforcement, and the intelligence community to identify the assets and accounts of terrorist organizations, money launderers, drug kingpins, weapons of mass destruction proliferators, and other national security threats, which strengthens compliance with sanctions programs designed to undercut financing and support for such persons;
- Helping financial institutions assess and mitigate risk, and comply with all existing legal requirements, including the BSA and related authorities;

⁸ See 77 FR 13046, March 5, 2012.

- Facilitating reporting and investigations in support of tax compliance, and advancing national commitments made to foreign counterparts in connection with the provisions commonly known as the Foreign Account Tax Compliance Act (FATCA);⁹ and
- Promoting consistency in implementing and enforcing CDD regulatory expectations across and within financial sectors.

i. Assisting Financial Investigations by Law Enforcement

The abuse of legal entities to disguise involvement in illicit financial activity remains a longstanding vulnerability that facilitates crime, threatens national security, and jeopardizes the integrity of the financial system. Criminals have exploited the anonymity that can be provided by legal entities to engage in a variety of financial crimes, including money laundering, corruption, fraud, terrorist financing, and sanctions evasion.

There are numerous examples. Law enforcement officials have found that major drug trafficking organizations use shell companies to launder drug proceeds.¹⁰ In 2011, a World Bank report highlighted how corrupt actors consistently abuse legal entities to conceal the proceeds of corruption, which the report estimates to aggregate to at least \$40 billion per year in illicit activity.¹¹ Other criminals also make aggressive use of front

⁹ Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111–147, Section 501(a).

¹⁰ *Combating Transnational Organized Crime: International Money Laundering as a Threat to Our Financial System, Before the Subcomm. on Crime, Terrorism, and Homeland Security, H. Comm. on the Judiciary, 112th Cong.* (February 8, 2012) (statement of Jennifer Shasky Calvery as Chief, Asset Forfeiture and Money Laundering Section, Criminal Division of the U.S. Department of Justice).

¹¹ *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*, The International Bank for Reconstruction and Development / The World Bank (2011).

companies, which may also conduct legitimate business activity, to disguise the deposit, withdrawal, or transfer of illicit proceeds that are intermingled with legitimate funds.

Strong CDD practices that include identifying the natural persons behind a legal entity – i.e., the beneficial owners – help defend against these abuses in a variety of ways. Armed with beneficial ownership information, financial institutions can provide law enforcement with key details about the legal structures used by suspected criminals to conceal their illicit activity and assets. Moreover, requiring legal entities seeking access to financial institutions to disclose identifying information, such as the name, date of birth, and social security number of a natural person, will make such entities more transparent, and thus less attractive to criminals and those who assist them. Even if an illicit actor tries to thwart such transparency by providing false beneficial ownership information to a financial institution, law enforcement has advised FinCEN that such information can still be useful in demonstrating unlawful intent and in generating leads to identify additional evidence or co-conspirators.

ii. Advancing Counterterrorism and Broader National Security Interests

As noted, criminals often abuse legal entities to evade sanctions or other targeted financial measures designed to combat terrorism and other national security threats. The success of such targeted financial measures depends, in part, on the ability of financial institutions, law enforcement, and intelligence agencies to identify a target's assets and accounts. These measures are thwarted when legal entities are abused to obfuscate ownership interests. Effective CDD helps prevent such abuses by requiring the collection

of critical information, including beneficial ownership information, which may be helpful in implementing sanctions or other similar measures.

iii. Improving a Financial Institution's Ability to Assess and Mitigate Risk

Express CDD requirements would also enable financial institutions to more effectively assess and mitigate risk. It is through CDD that financial institutions are able to develop risk profiles of their customers. Comprehensive risk profiles enable a financial institution to monitor accounts more effectively, and evaluate activity to determine whether it is unusual or suspicious, as required under suspicious activity reporting obligations.¹² Further, in the event that a financial institution files a suspicious activity report (SAR), information gathered through CDD enhances SARs, which in turn helps law enforcement, intelligence, national security and tax authorities investigate and pursue illicit financing activity.

iv. Facilitating Tax Compliance

Customer due diligence also facilitates tax reporting, investigations and compliance. For example, information held by banks and other financial institutions about the ownership of companies can be used to assist law enforcement in identifying the true owners of assets and their true tax liabilities. The United States has long been a global leader in establishing and promoting the adoption of international standards for transparency and information exchange to combat cross-border tax evasion and other financial crimes. Strengthening CDD is an important part of that effort, and it will dovetail with other efforts to create greater transparency, such as the new tax reporting

¹² See, e.g., 31 CFR 1020.320.

provisions under the Foreign Account Tax Compliance Act (FATCA).¹³ FATCA requires foreign financial institutions to identify U.S. account holders, including legal entities with substantial U.S. ownership, and to report certain information about those accounts to the Internal Revenue Service (IRS).¹⁴ The United States has collaborated with foreign governments to enter into intergovernmental agreements that facilitate the effective and efficient implementation of these requirements. These agreements and, to a lesser extent, the applicable FATCA regulations, allow foreign financial institutions to rely on existing AML practices in a number of circumstances, including, in the case of the agreements, for purposes of determining whether certain legal entity customers have substantial owners. Pursuant to many of these agreements, the United States has committed to pursuing reciprocity with respect to collecting and reporting to the authorities of the FATCA partner information on the U.S. accounts of residents of the FATCA partner. A general requirement for U.S. financial institutions to obtain beneficial ownership information for AML purposes advances this commitment, and puts the United States in a better position to work with foreign governments to combat offshore tax evasion and other financial crimes.

v. Promoting Clear and Consistent Expectations and Practices

Customer due diligence is universally recognized as fundamental to mitigating illicit finance risk, even though not all covered financial institutions use the specific term

¹³ Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111–147, Section 501(a).

¹⁴ *See generally*, Internal Revenue Service, “Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities,” RIN 1545-BK68 (January 28, 2013), *available at* <http://www.irs.gov/PUP/businesses/corporations/TD9610.pdf>. For further updates on FATCA regulations, see [http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-\(FATCA\)](http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA)).

“customer due diligence” to describe their practices. While Treasury understands from its outreach to the private sector that financial institutions broadly accept this principle and implement CDD practices in some form under a risk-based approach, covered financial institutions have expressed disparate views about what precise activity CDD entails. At public hearings held after the comment period to the ANPRM, discussed below, financial institutions described widely divergent CDD practices, especially with respect to identifying beneficial owners outside of limited circumstances prescribed by statute.¹⁵

FinCEN believes that this disparity adversely affects efforts to mitigate risk and can promote an uneven playing field across and within financial sectors. Covered financial institutions have noted that unclear CDD expectations can result in inconsistent regulatory examinations, potentially causing them to devote their limited resources to managing derivative legal risk rather than fundamental illicit finance risk. Private sector representatives have also noted that inconsistent expectations can effectively discourage best practices, because covered financial institutions with robust compliance procedures may believe that they risk losing customers to other, more lax institutions. Greater consistency across the financial system could also facilitate reliance on the CDD efforts of other financial institutions.

Providing a consolidated and clear CDD framework would help address these issues. As part of this framework, expressly stating CDD requirements in rule or

¹⁵ See, e.g., *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (October 5, 2012), available at <http://www.fincen.gov/whatsnew/html/20121130NYC.html> (“Participants expressed varied views as to whether, how and in what circumstances, financial institutions obtain beneficial ownership information.”).

regulation with respect to (i) understanding the nature and purpose of customer relationships and (ii) conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions, will facilitate more consistent implementation, supervision and enforcement of these expectations. With respect to the beneficial ownership proposal, requiring all covered financial institutions to identify beneficial owners in the same manner and pursuant to the same definition also promotes consistency across the industry. Requiring covered financial institutions to operate under one clear CDD framework will promote a more level playing field across and within financial sectors.

B. ISSUANCE OF THE ADVANCE NOTICE OF PROPOSED RULEMAKING AND SUBSEQUENT OUTREACH

FinCEN formally commenced this rulemaking process in March 2012 by issuing an ANPRM that described FinCEN's potential proposal for codifying explicit CDD requirements, including customer identification, understanding the nature and purpose of accounts, ongoing monitoring, and obtaining beneficial ownership information.¹⁶

FinCEN received approximately 90 comments, mostly from banks, credit unions, securities and derivatives firms, mutual funds, casinos, and money services businesses. In general, and as described in greater detail below, these commenters primarily raised concerns about the potential costs and practical challenges associated with a categorical requirement to obtain beneficial ownership information. They also reflected some confusion with respect to FinCEN's articulation of the other components of CDD,

¹⁶ Two years prior to that, in March 2010, FinCEN, along with several other agencies, published *Joint Guidance on Obtaining and Retaining Beneficial Ownership Information*, FIN-2010-G001 (March 5, 2010). Industry reaction to this guidance has been one reason for pursuit of the clarity entailed in making requirements with respect to CDD and beneficial ownership explicit within FinCEN's regulations.

suggesting that FinCEN was imposing new requirements rather than explicitly codifying pre-existing obligations.

To better understand and address these concerns, Treasury held five public hearings in Washington, DC, Chicago, New York, Los Angeles and Miami.¹⁷ At these meetings, participants expressed their views on the ANPRM and offered specific recommendations about how best to minimize the burden associated with obtaining beneficial ownership information. These discussions were critical in the development of this proposal.

C. TREASURY'S BROAD STRATEGY TO ENHANCE FINANCIAL TRANSPARENCY

Clarifying and strengthening CDD is an important component of Treasury's broader three-part strategy to enhance financial transparency. Other key elements of this strategy include: (i) increasing the transparency of U.S. legal entities through the collection of beneficial ownership information at the time of the legal entity's formation and (ii) facilitating global implementation of international standards regarding CDD and beneficial ownership of legal entities and trusts.

This proposal thus complements the Administration's ongoing work with Congress to facilitate adoption of legislation that would require the collection of beneficial ownership information at the time that legal entities are formed in the United

¹⁷ *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (July 31, 2012), available at <http://www.regulations.gov/#!documentDetail;D=FINCEN-2012-0001-0094>; *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (September 28, 2012), available at <http://www.fincen.gov/whatsnew/html/20121130CHI.html>; *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (October 5, 2012), available at <http://www.fincen.gov/whatsnew/html/20121130NYC.html>; *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (October 29, 2012), available at <http://www.fincen.gov/whatsnew/html/20121130LA.html>; *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (December 3, 2012), available at <http://www.fincen.gov/whatsnew/pdf/SummaryofHearing-MiamiDec3.pdf>.

States. This proposal also advances Treasury’s ongoing work with the Group of Twenty Finance Ministers and Central Bank Governors (G-20), the Financial Action Task Force (FATF), and other global partners, who have emphasized the importance of improving CDD practices and requiring the disclosure of beneficial ownership information at the time of company formation or transfer. Moreover, this proposal furthers the United States’ Group of Eight (G-8) commitment as set forth in the United States G-8 Action Plan for Transparency of Company Ownership and Control, published on June 18, 2013.¹⁸ This Action Plan is in line with principles agreed to by the G-8, which the White House noted “are crucial to preventing the misuse of companies by illicit actors.”¹⁹ While these elements are all proceeding independently, together they establish a comprehensive approach to promoting financial transparency.

II. SCOPE OF AND RATIONALE FOR THE PROPOSED RULE

This section describes: (i) the range of financial institutions covered by this proposal; (ii) FinCEN’s continued interest in potentially extending the proposed rule to additional financial institutions in the future, and (iii) the basis for proposing explicit requirements that, in conjunction with the existing customer identification program (CIP) requirement, will create a clearer CDD framework.

As an initial matter, this proposal covers only those financial institutions subject to a CIP requirement under FinCEN regulations. At this time, such financial institutions

¹⁸ United States G-8 Action Plan for Transparency of Company Ownership and Control, *available at* <http://www.whitehouse.gov/the-press-office/2013/06/18/united-states-g-8-action-plan-transparency-company-ownership-and-control>.

¹⁹ White House Fact Sheet: U.S. National Action Plan on Preventing the Misuse of Companies and Legal Arrangements (June 18, 2013), *available at* <http://www.whitehouse.gov/the-press-office/2013/06/18/fact-sheet-us-national-action-plan-preventing-misuse-companies-and-legal>.

are: (i) banks; (ii) brokers or dealers in securities; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers in commodities.²⁰ FinCEN believes that initially covering only these sectors is an appropriate exercise of its discretion to engage in incremental rulemaking. These sectors represent a primary means by which individuals and businesses maintain accounts with access to the financial system. In addition, because these covered financial institutions have been subject to CIP rules, FinCEN believes that it is logical to commence implementation with those financial institutions already equipped to leverage CIP practices to the extent possible, as the proposal contemplates.

In addition to input from covered financial institutions, FinCEN sought and received comments on the ANPRM from financial institutions not subject to CIP requirements, such as money services businesses, casinos, insurance companies, and other entities subject to FinCEN regulations. Based on these comments and discussions with the private sector, FinCEN believes that extending CDD requirements in the future to these, and potentially other types of financial institutions, may ultimately promote a more consistent, reliable, and effective AML regulatory structure across the financial system.

Several comments questioned the need for proposing a CDD rule that contained all four elements, when three of the four elements are already consistent with existing requirements or supervisory expectations. FinCEN believes that proposing clear CDD requirements is the most effective way of clarifying, consolidating, and harmonizing

²⁰ 31 CFR 1020.220 (Banks); 31 CFR 1023.220 (Broker-Dealers); 31 CFR 1024.220 (Mutual Funds); 31 CFR 1026.220 (Futures Commission Merchants and Introducing Brokers in Commodities).

expectations and practices across all covered financial institutions. Expressly stating the requirements facilitates the goal that financial institutions, regulators, and law enforcement all operate under the same set of clearly articulated principles. The proposed CDD requirements are intended to set forth a clear framework of minimum expectations that can be broadly applied to varying risk scenarios across multiple financial sectors and can be tailored by financial institutions to account for the risks unique to them. For this reason, and as part of a broader global agenda supported by Treasury, many other jurisdictions have already imposed requirements similar to those proposed herein.²¹ These global developments promote a level playing field internationally and mitigate the threat of illicit finance presented by an increasingly interconnected financial system.

Furthermore, additional discussions with the private sector reaffirmed FinCEN's view that a beneficial ownership requirement is best understood in the context of broader due diligence conducted on customers. Beneficial ownership information is only one component of a broader profile that is necessary for financial institutions to develop when assessing a particular customer's risk. Beneficial ownership information is a means of building a more comprehensive risk profile; it is not an end in and of itself. Thus, in addition to proposing a specific requirement for the collection of the beneficial ownership information, FinCEN is also proposing amendments to its AML program rules to specifically reference the two components of CDD that were not elsewhere explicitly

²¹ For example, all European Union member states, as well as Switzerland, Singapore, Hong Kong, and other financial centers generally require financial institutions to conduct due diligence as proposed in this rulemaking, including obtaining beneficial ownership information as part of their CDD requirements. *See, e.g.,* Third European Union Money Laundering Directive, 2005/60/EC, Article 3(6) (Oct. 26, 2005).

included in its regulations, i.e., understanding the nature and purpose of an account and conducting ongoing monitoring.

III. ELEMENTS OF THE PROPOSED RULE

A. OVERVIEW

As described briefly above, it is FinCEN's position that CDD consists, at a minimum, of four elements:

- Identifying and Verifying the Identity of Customers;
- Identifying and Verifying the Identity of Beneficial Owners of Legal Entity Customers;
- Understanding the Nature and Purpose of Customer Relationships; and
- Conducting Ongoing Monitoring to Maintain and Update Customer Information and to Identify and Report Suspicious Transactions.

Because the first element of CDD is already satisfied by existing CIP requirements,²² this NPRM proposes to address the remaining three elements of CDD.

Beneficial Ownership

The second element of CDD requires financial institutions to identify and verify the beneficial owners of legal entity customers. In this NPRM, FinCEN proposes a new requirement that financial institutions identify the natural persons who are beneficial owners of legal entity customers, subject to certain exemptions. The definition of "beneficial owner" proposed herein requires that the person identified as a beneficial

²² See, e.g., 31 CFR 1010.220.

owner be a natural person (as opposed to another legal entity). A financial institution must satisfy this requirement by obtaining at the time a new account is opened a standard certification form (attached hereto as Appendix A) directly from the individual opening the new account on behalf of the legal entity customer.

The term “beneficial owner” has been defined differently in different contexts. In the AML context, the Financial Action Task Force (FATF), the global standard setter for combating money laundering and the financing of terrorism and proliferation, defines the beneficial owner as “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” That definition, initially adopted in 2003, has been retained in the revised FATF standards adopted in 2012.²³ FinCEN has endeavored to capture both the concept of ownership and of effective control in its proposed definition.

Financial institutions would be required to verify the identity of beneficial owners consistent with their existing CIP practices. However, FinCEN is not proposing to require that financial institutions verify that the natural persons identified on the form are in fact the beneficial owners. In other words, the requirement focuses on verifying the identity of the beneficial owners, but does not require the verification of their status as beneficial owners. This proposed requirement states *minimum* standards. As will be described in greater detail below, FinCEN believes that the beneficial ownership

²³ “International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations,” February 2012, General Glossary, at 109, *available at* <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/internationalstandardscombatingmoneylaunderingandthefinancingofterrorismproliferation-thefatfrecommendations.html>.

requirement is the only new requirement imposed by this rulemaking. As such, although beneficial ownership identification is but one of four requirements for a comprehensive CDD scheme, the proposed beneficial ownership rule is being proposed as a separate provision in FinCEN's regulations; other components of this rulemaking will be addressed via amendments to existing provisions, as described below.

Understanding the Nature and Purpose of Customer Relationships/Monitoring for Suspicious Activity

The NPRM also addresses the third and fourth elements of CDD by proposing amendments to the AML program rule that harmonize these elements of CDD with existing AML obligations. The third element of CDD requires financial institutions to understand the nature and purpose of customer relationships in order to develop a customer risk profile. This is a necessary and critical step in complying with the existing requirement to identify and report suspicious transactions as required under the BSA. The fourth element of CDD requires financial institutions to conduct ongoing monitoring. As with the third element, ongoing monitoring is a necessary part of maintaining and updating customer information and identifying and reporting suspicious transactions as required under the BSA.

The third and fourth elements are consistent with, and in fact necessary in order to comply with, the existing requirement to report suspicious activity, as this obligation inherently requires a financial institution to understand expected customer activity in order to develop a customer risk profile and to monitor customer activity so that it can identify transactions that appear unusual or suspicious. As such, the third and fourth elements are intended to explicitly state already existing expectations for the purpose of

codifying the baseline standard of due diligence that is fundamental to an effective AML program.

Because these two elements are consistent with (and necessary in order to comply with) existing BSA requirements as adopted in regulations or rules issued by federal functional regulators and SROs, nothing in this proposed rule should be interpreted in a manner inconsistent with previous guidance issued by FinCEN or guidance, regulations, or supervisory expectations of the appropriate federal functional regulator or SRO with respect to these elements.²⁴ For example, the Federal Financial Institutions Examination Council (FFIEC)²⁵ provided supervisory expectations for examinations related to CDD in the FFIEC BSA/AML Examination Manual.²⁶ FinCEN believes that, aside from the new beneficial ownership requirement, the other proposed CDD elements are consistent with the regulatory expectations of the federal functional regulators and should be interpreted accordingly.²⁷ Of course, as the CDD requirements proposed herein state *minimum* standards, existing or future guidance, regulations or supervisory expectations may provide for additional requirements or steps that should be taken to mitigate risk.

²⁴ While FinCEN reserves overall compliance and enforcement authority with respect to all regulations it issues under the BSA, FinCEN has, by regulation, delegated authority to the federal functional regulators to examine institutions under their jurisdiction for compliance with BSA regulations, including the AML program requirements. *See* 31 CFR 1010.810.

²⁵ The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau, and to make recommendations to promote uniformity in the supervision of financial institutions.

²⁶ The Bank Secrecy Act Anti-Money Laundering Examination Manual, issued by the Federal Financial Institutions Examination Council (as amended, the “BSA/AML Manual”).

²⁷ The future status of previous guidance related to identifying beneficial owners of legal entity customers, such as the *Joint Guidance on Obtaining and Retaining Beneficial Ownership Information*, FIN-2010-G001 (March 5, 2010), will be addressed at the time of the issuance of a final rule.

The sections below further describe each of the three CDD elements addressed in this rulemaking in detail by providing a general overview of these elements as discussed in the ANPRM, a summary of the comments received, and FinCEN's specific proposal.

B. IDENTIFYING AND VERIFYING THE IDENTITY OF BENEFICIAL OWNERS OF LEGAL ENTITY CUSTOMERS

With respect to this element of CDD,²⁸ the ANPRM explored a categorical requirement for financial institutions to identify the beneficial owners of legal entity customers. Unlike the other elements of CDD, this element would impose a new regulatory obligation on financial institutions. Currently, certain financial institutions are explicitly required to take reasonable steps to identify beneficial owners in only two limited situations.²⁹

i. Summary of Comments

1. Private Sector Comments

While a number of private sector comments offered general support for a reasonable expansion of the beneficial ownership requirement and noted that many financial institutions already identify beneficial owners in certain circumstances beyond those explicitly required under the regulations implementing Section 312 of the PATRIOT Act, most expressed the following primary criticisms and concerns:

²⁸ For purposes of clarity, this NPRM references the elements of CDD in a different order than was used in the ANPRM; Identifying and Verifying the Identity of the Beneficial Owners of Legal Entity Customers is now listed before Understanding the Nature and Purpose of Customer Relationships.

²⁹ Under FinCEN regulations implementing Section 312 of the USA PATRIOT Act (Section 312), covered financial institutions that offer private banking accounts are required to take reasonable steps to identify the nominal and beneficial owners of such accounts, 31 CFR 1010.620(b)(1), and covered financial institutions that offer correspondent accounts for certain foreign financial institutions are required to take reasonable steps to obtain information from the foreign financial institution about the identity of any person with authority to direct transactions through any correspondent account that is a payable-through account, and the sources and beneficial owner of funds or other assets in the payable-through account, 31 CFR 1010.610(b)(1)(iii)(A).

- The burden and costs associated with a categorical (versus a risk-based) obligation to collect beneficial ownership information may outweigh the benefits;
- An express beneficial ownership requirement should be (at least in part) risk-based to account for the wide variety of financial institutions, account types, products, and customers that comprise the financial system, and to avoid requiring financial institutions to misallocate scarce compliance resources away from high-risk customers;
- A categorical requirement should include exemptions, including for those customers currently exempt from customer identification requirements;
- Any definition of “beneficial owner” should be practical and easily understood by financial institution employees and customers;
- Financial institutions may be unable to verify the status of a beneficial owner absent an independent source of beneficial ownership information, such as a state registry; and
- FinCEN should consider the compliance challenges associated with specific account and relationship types, such as intermediated relationships and trusts.

2. Law Enforcement Comments

Most of the comment letters submitted by law enforcement agencies and non-governmental organizations also focused on the beneficial ownership element of the CDD rule. In general, these letters highlighted the following benefits that such an obligation would provide:

- A beneficial ownership rule would require financial institutions to retain more useful customer information, which would significantly improve law

enforcement's ability to pursue new leads with respect to legal entities under investigation;

- Beneficial ownership information would improve financial institutions' monitoring capabilities, and put them in a position to file higher quality SARs; and
- Obtaining beneficial ownership information for U.S. legal entities would enhance the United States' ability to respond to a foreign jurisdiction's request for investigative assistance. This would assist in efforts to join with foreign counterparts in global efforts to disrupt organized crime and terrorism.

ii. Key Issues and FinCEN Proposals

As described above, Treasury has engaged in extensive outreach with the private sector and law enforcement agencies to better understand and address these issues. Such discussions were essential in further developing the initial proposals set forth in the ANPRM to better conform with existing practices and more comprehensively account for regulatory burden and sector-specific complexities. Key issues raised during the comment period included: the definition of "beneficial owner" and "legal entity customer"; exemptions and exclusions from the definition; application of the requirement to trusts, intermediated account relationships and pooled investment vehicles; verification of beneficial owners through a standard certification; updating beneficial ownership information; and reliance on other financial institutions to satisfy the requirement. Each of these issues is described in further detail below.

1. Definition of "Beneficial Owner"

The ANPRM explored a definition of “beneficial owner” with two independent components, referred to as “prongs.”³⁰ The first prong was an *ownership prong*, the purpose of which is to identify individuals with substantial equity ownership interests. The second prong was a *control prong*, the purpose of which was to identify individuals with actual managerial control.

Many private sector commenters stated that the definition discussed in the ANPRM was conceptually confusing and unworkable in practice. For example, some commenters questioned the feasibility of engaging in a comparative analysis of every owner for purposes of determining who “has at least as great an equity interest in the entity as any other individual.” A similar type of comparative analysis existed with respect to the control prong. Other commenters were uncertain as to whether an individual must satisfy both the ownership prong and the control prong to be considered a beneficial owner, or whether each prong was intended to be independently applied to identify separate individuals. Other challenges identified in the comments included, among other things: (i) shifting ownership percentages; (ii) managerial changes; and (iii) the ability of financial institution personnel and customers to understand and respond to the definition.

FinCEN agrees that the definition of “beneficial owner” must be clear to employees and customers of financial institutions. To that end, and in light of the

³⁰ The ANPRM suggested the following definition of “beneficial owner”:
(1) either: (a) each of the individual(s) who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity, or otherwise, owns more than 25 percent of the equity interests in the entity; or (b) if there is no individual who satisfies (a), then the individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity, or otherwise, has at least as great an equity interest in the entity as any other individual, and (2) the individual with greater responsibility than any other individual for managing or directing the regular affairs of the entity.

comments received, FinCEN proposes the following definition of “beneficial owner” of a legal entity customer, which, again, includes an ownership prong and a control prong:

Ownership Prong:

1. Each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of a legal entity customer;

and

Control Prong:

2. An individual with significant responsibility to control, manage, or direct a legal entity customer, including
 - (A) An executive officer or senior manager (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, or Treasurer); or
 - (B) Any other individual who regularly performs similar functions.

Each prong is intended to be an independent test. Under the ownership prong (i.e., clause (1)), a financial institution must identify *each* individual who owns 25 percent or more of the equity interests. Accordingly, a financial institution would be required to identify no more than four individuals under this prong, and, if no one individual owns 25 percent or more of the equity interests, then the financial institution may identify no individuals under the ownership prong. Under the control prong (clause (2)), a financial institution must identify *one* individual. In cases where an individual is both a 25 percent owner and meets the definition for control, that same individual could be identified as a beneficial owner under both prongs.

FinCEN believes this definition provides clarity and effectiveness. In contrast to the definition suggested in the ANPRM, this definition provides greater flexibility to financial institutions and customers in responding to the control prong of the definition by permitting the identification in clause (ii) of *any* individual with significant managerial control, which could include a President, Chief Executive Officer or other senior executive, or any other individual acting in a similar capacity. Moreover, this definition does not require a financial institution to comparatively assess individuals to determine who has the greatest equity stake in the legal entity. The 25 percent equity ownership threshold set forth in the ownership prong of the definition sets a clear standard that can be broadly applied. At the same time, the 25 percent threshold retains the benefits of identifying key individuals with a substantial ownership interest in the legal entity.

Commenters expressed concern that identifying beneficial owners under the ownership prong would be difficult for legal entity customers that have complex legal ownership structures. FinCEN acknowledges that identifying the individuals who own, directly or indirectly, 25 percent or more of the equity interests of a legal entity may not be straightforward in every circumstance. For instances where legal entities are held by other legal entities, determining ownership may require several intermediate analytical steps. FinCEN's expectation is that a financial institution will identify the natural person or persons who exercise control of a legal entity customer through a 25% or greater ownership interest, regardless of how many corporate parents or holding companies removed the natural person is from the legal entity customer. Consequently, the term "equity interests" should be interpreted broadly to apply to a variety of different legal structures and ownership situations. In short, "equity interests" refers to an ownership

interest in a business entity. Examples of “equity interests” include shares or stock in a corporation, membership interests in a limited liability company, and other similar ownership interests in a legal entity. FinCEN has deliberately avoided use of more specific terms of art associated with the exercise of control through ownership, based on the preferences expressed by many members of industry, who have urged FinCEN to avoid creating a definition with complex legal terms that front-line employees at financial institutions, and the individuals opening accounts on behalf of legal entity customers, might have difficulty understanding and applying.

Moreover, the phrase “directly or indirectly” in the ownership prong of the definition is intended to make clear that where a legal entity customer is owned by (or controlled through) one or more other legal entities, the proposed rule requires customers to look through those other legal entities to determine which natural persons own 25 percent or more of the equity interests of the legal entity customer. FinCEN recognizes that identifying such individuals may be challenging where the legal entity customer has a complex legal structure with multiple levels of ownership, but FinCEN does not expect financial institutions – or customers – to undergo complex and exhaustive analysis to determine with legal certainty whether an individual is a beneficial owner under the definition. Instead, FinCEN expects financial institutions to be able to rely generally on the representations of the customer when answering the financial institution’s questions about the individual persons behind the legal entity, including whether someone identified as a beneficial owner is in fact a beneficial owner under this definition. FinCEN believes that this approach provides greater flexibility to financial institutions and customers in complying with the proposed beneficial ownership requirement. In

addition, by using the term “directly or indirectly,” FinCEN does not intend for financial institutions to assess under this prong whether individuals are acting in concert with one another to collectively own 25 percent or more of the legal entity where each of them has an independent contributing stake; FinCEN is concerned, however, with the use of *de facto* or *de jure* nominees to give a single individual an effective ownership stake of 25 percent or more. In this instance as well, however, FinCEN expects financial institutions to be able to rely generally on the representations of the customer when answering the financial institution’s questions about the individual persons behind the legal entity.

FinCEN has learned through its outreach that some financial institutions may already identify beneficial owners using a lower ownership threshold, such as 10 percent. FinCEN reiterates that the proposed CDD requirements, including the beneficial ownership requirement, are intended to set forth *minimum* due diligence expectations. Accordingly, a financial institution may determine, based on its own assessment of risk, that a lower percentage threshold, such as 10 percent, is warranted. A financial institution may also identify other individuals that technically fall outside the proposed definition of “beneficial owner,” but may be relevant to mitigate risk. For example, as noted above, a financial institution may be aware of a situation in which multiple individuals with independent holdings may act in concert with each other to structure their ownership interest to avoid the 25 percent threshold. A financial institution may also be aware of an individual who effectively controls a legal entity customer through a substantial debt position. While these individuals do not fall within the proposed definition of “beneficial owner,” the proposed rule is not intended to preclude a financial

institution from identifying them, and verifying their identity, when it deems it appropriate to do so.

Commenters also sought clarity as to how this beneficial ownership requirement would affect the application of FinCEN regulations implementing Section 312 of the USA PATRIOT Act. The proposed requirement would apply to all legal entity customers, including legal entities that open a foreign private banking account that meets the definition in § 1010.605(m). However, the new requirements would not apply to the beneficial owner of funds or assets in a payable-through account of the type described in § 1010.610(b)(1)(iii), since the owner of such funds or assets does not have an account relationship with the covered financial institution. In such instances, compliance with the information requirements included in § 1010.610(b)(1)(iii) will suffice, and the particulars of this new requirement, such as use of a certification form with respect to the beneficial owner of funds or assets in a payable-through account, would not apply.

2. Definition of Legal Entity Customer

While the ANPRM sought comment on whether certain legal entity customers should be exempt from the beneficial ownership requirement, it did not include a discussion of the scope of the definition of legal entity customer, which is also relevant to the notion of the exemptions. FinCEN proposes to define legal entity customers to include corporations, limited liability companies, partnerships or other similar business entities (whether formed under the laws of a state or of the United States or a foreign jurisdiction), that open a new account after the implementing date of the regulation. FinCEN would interpret this to include all entities that are formed by a filing with the Secretary of State (or similar office), as well as general partnerships and unincorporated

nonprofit associations. It does not include trusts other than those that might be created through a filing with a state (e.g., statutory business trusts).

3. Exemptions and Exclusion from the Beneficial Ownership Requirement

Many commenters strongly recommended that, at a minimum, any customer exempt from identification under the CIP rules should also be exempt from the beneficial ownership requirement. The commenters noted that a contrary approach would effectively nullify the CIP exemption since a financial institution would be unable to identify a beneficial owner without first identifying the customer. Many commenters recommended that other customers should also be exempt if they are well-regulated or otherwise present a low money laundering risk. The proposed rule incorporates a number of these suggestions by exempting all types of entities that are exempt from CIP, as well as allowing for other specific exemptions.

a. Customers Exempt from CIP

FinCEN proposes to exempt from the beneficial ownership requirement those types of entities that are exempt from the customer identification requirements under the CIP rules.³¹ Those types of entities include, but are not limited to, financial institutions

³¹ Although we propose to include the *types* of entities exempted from the CIP requirements, the exemption proposed for this rule would not cover all the entities included in the exemption from the CIP requirements. This is because FinCEN does not propose to include an exemption for legal entities with existing accounts that open new accounts after the implementation date of the rule. The inclusion of such an exemption would parallel the exemption in the CIP requirements per the definition of “customer.” *See, e.g.* 31 CFR 1020.100(c)(2)(iii) and 1023.100(d)(2)(iii). However, FinCEN believes that such an approach would not serve the purposes of the present rule. In situations where a legal entity is opening an account in addition to a previously existing account, the new requirement will apply. If the pre-existing account pre-dates the implementation date of the rule, the financial institution will need to obtain the certification form. If the pre-existing account was established after the implementation date, it may be reasonable for a financial institution to rely on the certification obtained when opening the first account in some circumstances. In other circumstances, collection of an additional certificate may be necessary. The likelihood of change in

regulated by a federal functional regulator (i.e., federally regulated banks, brokers or dealers in securities, mutual funds, futures commission merchants and introducing brokers in commodities), publicly held companies traded on certain U.S. stock exchanges, domestic government agencies and instrumentalities and certain legal entities that exercise governmental authority.³² These exemptions are incorporated into the proposed beneficial ownership requirement by excluding these entities from the definition of “legal entity customer,” which corresponds to how these entities are exempted from CIP (i.e., by excluding them from the definition of “customer”).³³ Consequently, the definition of “legal entity customer” for purposes of the beneficial ownership requirement excludes all the same types of entities as the definition of “customer” for purposes of the CIP rules, including exclusions based on guidance issued by FinCEN and the federal functional regulators with regard to the applicability of the CIP rules. For example, where previous guidance has clarified who a “customer” is in a particular relationship, that same analysis would generally apply in determining whether an entity is a “legal entity customer” for purposes of the proposed beneficial ownership requirement.³⁴

beneficial ownership since the time of the previous account opening would be a key factor in a financial institution’s approach to the requirement.

³² See, e.g., 31 CFR 1020.100(c)(2)(i).

³³ See, e.g., 31 CFR 1020.100(c)(2)(ii).

³⁴ See, e.g., FinCEN Guidance, FIN-2007-G001, Application of the Customer Identification Program Rule to Futures Commission Merchants Operating as Executing and Clearing Brokers in Give-Up Arrangements (April 20, 2007), *available at* http://www.fincen.gov/statutes_regs/guidance/html/cftc_fincen_guidance.html; FinCEN Guidance, FIN-2006-G004, Frequently Asked Question Regarding Customer Identification Programs for Futures Commission Merchants and Introducing Brokers (31 CFR 103.123 (February 14, 2006)), *available at* http://www.fincen.gov/statutes_regs/guidance/html/futures_omnibus_account_qa_final.html; Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA

b. Additional Exemptions for Certain Legal Entity Customers

In addition to incorporating exemptions applicable to the CIP rules, and consistent with various suggestions provided in the comment letters, FinCEN proposes that the following entities also be exempt from the beneficial ownership requirement when opening a new account because their beneficial ownership information is generally available from other credible sources:

- An issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934 or that is required to file reports under Section 15(d) of that Act;
- Any majority-owned domestic subsidiary of any entity whose securities are listed on a U.S. stock exchange;
- An investment company, as defined in Section 3 of the Investment Company Act of 1940, that is registered with the SEC under that Act;
- An investment adviser, as defined in Section 202(a)(11) of the Investment Advisers Act of 1940, that is registered with the SEC under that Act;
- An exchange or clearing agency, as defined in Section 3 of the Securities Exchange Act of 1934, that is registered under Section 6 or 17A of that Act;
- Any other entity registered with the Securities and Exchange Commission under the Securities and Exchange Act of 1934.

PATRIOT Act at Question 9 (April 28, 2005), *available at* http://www.fincen.gov/statutes_regs/guidance/html/faqsfinalciprule.html; Guidance from the Staffs of the Department of the Treasury and the U.S. Securities and Exchange Commission, Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule (31 CFR 103.122) (October 1, 2003), *available at* http://www.fincen.gov/statutes_regs/guidance/html/20031001.html.

- A registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, each as defined in section 1a of the Commodity Exchange Act, that is registered with the CFTC;
- A public accounting firm registered under section 102 of the Sarbanes-Oxley Act; and
- A charity or nonprofit entity that is described in Sections 501(c), 527, or 4947(a)(1) of the Internal Revenue Code of 1986, that has not been denied tax exempt status, and that is required to and has filed the most recently required annual information return with the Internal Revenue Service.

FinCEN notes that exempting these entities from the beneficial ownership requirement does not necessarily imply that they all present a low risk of money laundering or terrorist financing. For example, a charity may present a high risk of terrorist financing and therefore require additional due diligence. However, charities are exempt because the legal structure of a charity as a tax exempt organization does not create a beneficial ownership interest in the sense discussed above. Rather the primary interests created by a charitable structure include donors, board oversight and management, employees, and beneficiaries. Under such a structure, board oversight is akin to ownership, and management is akin to control. In order to obtain and maintain such a legal structure under the tax code the charity must report and annually update its donors, board and management to the Internal Revenue Service. Such reports must be publicly available.³⁵

³⁵ See *Public Disclosure and Availability of Exempt Organizations Returns and Applications: Documents Subject to Public Disclosure*, available at <http://www.irs.gov/Charities-&-Non-Profits/Public-Disclosure->

c. Existing and New Customers

FinCEN also sought comment on whether and how a beneficial ownership requirement should apply to customers of financial institutions where such relationships have been established prior to the implementation date of this rule. Financial institutions noted that a requirement to “look back” to obtain beneficial ownership information from existing customers would be a substantial burden. FinCEN proposes that the beneficial ownership requirement will apply only with respect to legal entity customers that open new accounts going forward from the date of implementation. Thus, the definition of “legal entity customer” is limited to legal entities that open a new account after the implementation date. Although FinCEN is not proposing a prescriptive rule requiring financial institutions to look back and obtain beneficial ownership information for pre-existing accounts, we are aware that, as a matter of practice, financial institutions may also consider identifying beneficial owners of existing customers when updating customer information on a risk basis, as discussed more fully below.³⁶

4. Trusts

Several comments described potential challenges in applying a beneficial ownership requirement to a customer that is a trust. There are many types of trusts. While a small proportion may fall within the scope of the proposed definition of legal entity customer (e.g., statutory trusts), most will not. Unlike the legal entity customers that are subject to the proposed beneficial ownership requirement (corporations, limited liability companies, etc.), a trust is generally a contractual arrangement between the

and-Availability-of-Exempt-Organizations>Returns-and-Applications:-Documents-Subject-to-Public-Disclosure.

³⁶ See the discussion in Section III.d of this notice, entitled “Ongoing Monitoring.”

person who provides the funds and specifies the trust terms (i.e., the settlor or grantor) and the person with control over the funds (i.e., the trustee) for the benefit of those who benefit from the trust (i.e., the beneficiaries). This arrangement does not generally require the approval by or other action of a state to become effective. FinCEN notes that in order to engage in the business of acting as a fiduciary it is necessary for a trust company to be federally- or state-chartered. As the comments noted, identifying a “beneficial owner” among the parties to such an arrangement for AML purposes, based on the proposed definition of beneficial owner, would not be practical. At this point, FinCEN is choosing not to impose this requirement. In this context we note that, although the trust is defined in the CIP rules as the financial institution’s customer, the signatory on the account will necessarily be the trustee, who is required by law to control the trust assets (including financial institution accounts) and to know the beneficiaries (by name or class) and act in their best interest. Therefore, in the context of an investigation, law enforcement would be able to obtain from the financial institution a point of contact required by law to have information about relevant individuals associated with the trust.

The decision not to propose specific requirements in the context of trusts does not mean, however, that FinCEN necessarily considers trusts to pose a reduced money laundering or terrorist financing risk relative to the business entities included within the definition of “legal entity customer.” Through its outreach, FinCEN learned that, in addition to identifying and verifying the identity of the trust for purposes of CIP, financial institutions generally also identify and verify the identity of the trustee, who would necessarily have to open the account for the trust. In addition, guidance for banks provides that “in certain circumstances involving revocable trusts, the bank may need to

gather information about the settlor, grantor, trustee, or other persons with the authority to direct the trustee, and who thus have authority or control over the account, in order to establish the true identity of the customer.”³⁷ In other words, given the variety of possible trust arrangements and the number of persons who may have roles in them, financial institutions are already taking a risk-based approach to collecting information with respect to various persons for the purpose of knowing their customer. FinCEN expects financial institutions to continue these practices as part of their overall efforts to safeguard against money laundering and terrorist financing, and will consider additional rulemaking or guidance to strengthen or clarify this expectation.

5. Intermediated Account Relationships and Pooled Investment Vehicles

The ANPRM sought comment on whether and how a beneficial ownership requirement should be applied to accounts held by intermediaries on behalf of third parties. An intermediary generally refers to a customer that maintains an account for the primary benefit of others, such as the intermediary’s own underlying clients. For example, certain correspondent banking relationships may involve intermediation whereby the respondent bank of a correspondent bank acts on behalf of its own clients. Intermediation is also very common in the securities and derivatives industries. For example, a broker-dealer may establish omnibus accounts for a financial intermediary (such as an investment adviser) that, in turn, establishes sub-accounts for the intermediary’s clients, whose information may or may not be disclosed to the broker-dealer. An issue raised in the comments, especially those from the securities and

³⁷ FFIEC BSA Exam/AML Manual at 286-87.

derivatives industries, is whether a financial institution would be required to identify the intermediary's own underlying clients or their beneficial owners. This issue is distinct from whether a financial institution must identify the beneficial owners of the intermediary (i.e., the direct customer), which would be the case unless the intermediary is exempt under one of the specific exemptions described above.

Commenters cautioned that a requirement to identify an intermediary's underlying clients or their beneficial owners could have significant detrimental consequences to the efficiency of the U.S. financial markets, because it would require financial institutions to modify longstanding practices. They suggested that, consistent with existing CIP guidance related to certain intermediated relationships, a beneficial ownership requirement should apply only with respect to a financial institution's immediate customer, the intermediary, and not the intermediary's underlying clients.

FinCEN is concerned about the illicit finance risks posed by underlying clients of intermediary customers because of the lack of insight a financial institution has into those clients and their activities. However, FinCEN recognizes that this risk may be more effectively managed through other means. These would include proper customer due diligence conducted by financial institutions on their direct customers who serve as intermediaries, and appropriate regulation of the intermediaries themselves.³⁸

Therefore, for purposes of the beneficial ownership requirement, if an intermediary is the customer, and the financial institution has no CIP obligation with respect to the intermediary's underlying clients pursuant to existing guidance, a financial institution

³⁸ FinCEN recognizes that some such intermediary entities are already subject to BSA requirements, while others or not. FinCEN continues to consider which additional entities may need to be brought within the scope of the FinCEN's regulations.

should treat the intermediary, and not the intermediary's underlying clients, as its legal entity customer.

Existing FinCEN guidance related to CIP practices is applicable in determining a financial institution's beneficial ownership obligations in these circumstances. For example, a broker-dealer that appropriately maintains an omnibus account for an intermediary, under the conditions set forth in the 2003 Omnibus Guidance for Broker-Dealers,³⁹ may treat the intermediary, and not the underlying clients, as its legal entity customer for purposes of the beneficial ownership requirement.⁴⁰ Pursuant to a clearing agreement that allocates functions in the manner described in the 2008 No-Action Position Respecting Broker-Dealers Operating Under Fully Disclosed Clearing Agreements According to Certain Functional Allocations,⁴¹ only the introducing firm would be obligated to obtain beneficial ownership information of the customers introduced to the clearing firm. Similarly, based on guidance issued to the futures industry in the context of give-up arrangements, because the clearing broker, and not the

³⁹ Guidance from the Staffs of the Department of the Treasury and the U.S. Securities and Exchange Commission, *Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule (31 CFR 103.122)* (October 1, 2003), available at http://www.fincen.gov/statutes_regs/guidance/html/20031001.html.

⁴⁰ See also Guidance from the Staffs of the Department of the Treasury and the U.S. Commodity Futures Trading Commission, *Frequently Asked Question regarding Customer Identification Programs for Futures Commission Merchants and Introducing Brokers (31 CFR 103.123)*, available at http://www.fincen.gov/statutes_regs/guidance/html/futures_omnibus_account_qa_final.html; FinCEN Guidance, FIN-2006-G009, *Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to the Securities and Futures Industries* (May 10, 2006), available at http://www.fincen.gov/statutes_regs/guidance/html/312securities_futures_guidance.html. FinCEN also notes that in such circumstances, the intermediary itself may be exempt from the beneficial ownership requirement if it satisfies one of the specific exemptions.

⁴¹ FinCEN Guidance, FIN-2008-G002, *Customer Identification Program Rule No-Action Position Respecting Broker-Dealers Operating Under Fully Disclosed Clearing Agreements According to Certain Functional Allocations* (March 4, 2008), available at http://www.fincen.gov/statutes_regs/guidance/html/fin-2008-g002.html.

executing broker, has a formal relationship with its customer, only the clearing broker would be responsible for obtaining beneficial ownership information regarding the underlying customer.⁴²

Notwithstanding the foregoing, consistent with other elements of CDD, a financial institution's AML program should contain risk-based policies, procedures, and controls for assessing the money laundering risk posed by underlying clients of a financial intermediary, for monitoring and mitigating that risk, and for detecting and reporting suspicious activity. While a financial intermediary's underlying clients may not be subject to the beneficial ownership requirement, a financial institution would nonetheless be obligated to monitor for and report suspicious activity associated with intermediated accounts, including activity related to underlying clients. FinCEN understands that this is consistent with current industry practice. As multiple comments noted, securities and derivatives firms generally monitor activity in intermediated accounts and follow up on an event-driven basis, with such follow-up potentially including asking questions about the underlying owners of assets after detection of possible suspicious activity.⁴³ Such practice is also consistent with the third and fourth elements of the CDD requirements described below. FinCEN thus expects financial institutions to continue engaging in this practice.

Several comments, particularly from the securities and futures industries, also highlighted the potential challenges associated with identifying beneficial owners of non-

⁴² FinCEN Guidance, FIN-2007-G001, *Application of the Customer Identification Program Rule to Future Commission Merchants Operating as Executing and Clearing Brokers in Give-Up Arrangements* (April 20, 2007), available at http://www.fincen.gov/statutes_regs/guidance/html/cftc_fincen_guidance.html.

⁴³ See, e.g., letter from SIFMA dated June 8, 2012 at 7, available at <http://www.sifma.org/issues/item.aspx?id=8589938990>.

exempt pooled investment vehicles, such as hedge funds, whose ownership structure may continuously fluctuate.⁴⁴ The comments noted that identifying beneficial owners of these entities based on a percentage ownership threshold may create unreasonable operational challenges for the purpose of obtaining information that may only be accurate for a limited period of time.

FinCEN is considering whether nonexempt pooled investment vehicles that are operated or advised by financial institutions that are proposed to be exempt, should also be exempt from this requirement. Additionally, in the event that such institutions are not exempt, FinCEN is considering whether covered financial institutions should only be required to identify beneficial owners of such non-exempt pooled investment vehicles⁴⁵ under the control prong of the “beneficial owner” definition, as opposed to both the ownership prong and control prong, in order to alleviate the operational and logistical difficulties that would be associated with complying with the ownership prong. FinCEN is also considering whether such an approach, if adopted, may best be addressed through inclusion of such vehicles within the scope of the rule with subsequent guidance or a

⁴⁴ For purposes of this discussion, a “non-exempt pooled investment vehicle” means (i) any company that would be an investment company as defined in Section 3(a) of the Investment Company Act of 1940, but for the exclusion provided by either Section 3(c)(1) or Section 3(c)(7) of that Act; or (ii) any commodity pool under section 1a(10) of the Commodity Exchange Act (CEA) that is operated by a commodity pool operator registered with the CFTC under Section 4m of the CEA.

⁴⁵ See, e.g., Securities Industry and Financial Markets Association (SIFMA) Anti-Money Laundering and Financial Crimes Committee, *Anti-Money Laundering Suggested Due Diligence Practices for Hedge Funds* (2009), available at http://www.sifma.org/uploadedfiles/issues/legal_compliance_and_administration/anti-money_laundering_compliance/issues_anti-money%20laundering_suggested%20due%20diligence%20practices%20for%20hedge%20funds.pdf; Securities Industry Association Anti-Money Laundering Committee, *Suggested Practices for Customer Identification Programs*, §3.9, available at http://www.sifma.org/uploadedfiles/issues/legal_compliance_and_administration/anti-money_laundering_compliance/issues_anti-money%20laundering_suggested%20practices%20for%20customer%20identification%20programs.pdf.

specific exemption or exception from the application of the ownership prong of the requirement. FinCEN believes this approach may sufficiently balance benefit with burden given the unique ownership structure of pooled investment vehicles.

6. Verification of Beneficial Owners

a. *Standard Certification Form*

At the public hearings, participants discussed the efficacy of having a certification form that would standardize collection of beneficial ownership information and permit reliance on the information provided. FinCEN believes that providing such a form would promote consistent practices and regulatory expectations, significantly reduce compliance burden, and preserve the benefits of obtaining the information. A standard form would also promote a uniform customer experience across U.S. financial sectors. This was of particular concern to representatives from financial institutions with practices that exceed existing regulatory requirements, which noted that they often lose customers to institutions with less rigorous standards.

Accordingly, FinCEN proposes that a financial institution must satisfy the requirement to identify beneficial owners by obtaining, at the time a new account is opened, the standard certification form attached hereto as Appendix A. To promote consistent customer expectations and understanding, the form in Appendix A plainly describes the beneficial ownership requirement and the information sought from the individual opening the account on behalf of the legal entity customer. To facilitate reliance by financial institutions, the form also requires the individual opening the account on behalf of the legal entity customer to certify that the information provided on the form is true and accurate to the best of his or her knowledge. This certification is also

helpful for law enforcement purposes in demonstrating unlawful intent in the event the individual completing the form knowingly provides false information.

b. Verification of Beneficial Owners

The ANPRM sought comment on whether and how financial institutions could verify beneficial ownership information provided by customers. As described in the ANPRM, verification could have two meanings. One meaning would require verifying the *identity* of an individual identified as a beneficial owner (i.e., to verify the existence of the identified beneficial owner by collecting, for example, a driver's license or other similar identification document). The second possible meaning would require financial institutions to verify that an individual identified as a beneficial owner is in fact a beneficial owner (i.e., to verify the *status* of an individual as a beneficial owner).

Many comments cautioned that a requirement to verify the *status* of a beneficial owner would be prohibitively costly and impracticable in many circumstances. They recommended that financial institutions be permitted to rely on information provided by the customer. With respect to verifying the *identity* of a beneficial owner, participants at the public hearings generally acknowledged that this would be a manageable task so long as the verification procedures are comparable to current CIP requirements. Many participants further agreed that verification of identity would substantially improve the credibility of the beneficial ownership information collected. In addition, law enforcement has indicated that verification of identity would also facilitate investigations, even if the verified individual is not the true beneficial owner because of the ability to locate and investigate that person.

In light of these considerations, FinCEN is not proposing to require that financial institutions verify the *status* of a beneficial owner. Financial institutions may rely on the beneficial ownership information provided by the customer on the standard certification form. FinCEN believes this addresses a key concern raised by the private sector about the burden and costs associated with a beneficial ownership requirement.

For verifying the identity of a beneficial owner, FinCEN proposes that financial institutions verify the identity using existing risk-based CIP practices. As such, the proposed rule provides that a financial institution must implement risk-based procedures to verify the identity of each beneficial owner according to procedures that comply with the CIP requirements to verify the identity of customers that are natural persons.

Therefore, a financial institution may verify the identity of a beneficial owner using documentary or non-documentary methods, as it deems appropriate under its procedures for verifying the identity of customers that are natural persons. These procedures should enable the financial institution to form a reasonable belief that it knows the true identity of the beneficial owner of each legal entity customer. A financial institution must also include procedures for responding to circumstances in which it cannot form a reasonable belief that it knows the true identity of the beneficial owner, as described under the CIP rules. Because these practices are already well-established and understood at covered financial institutions, FinCEN expects that these institutions will leverage existing compliance procedures.

7. Updating Beneficial Ownership Information

Many financial institutions sought clarity as to whether they would be required to update or refresh periodically the beneficial ownership information obtained under this rule. FinCEN is not proposing such a requirement but notes that, as a general matter, a

financial institution should keep CDD information, including beneficial ownership information, as current as possible and update as appropriate on a risk-basis. For example, a financial institution may determine that updating beneficial ownership information is appropriate after a customer has been identified as engaging in suspicious activity or exhibits other red flags, which FinCEN believes is generally consistent with existing practice for updating other customer information.

Factors that may be relevant in considering whether and when to update beneficial ownership information could include the type of business engaged in by the legal entity customer, changes in business operations or management of which the financial institution becomes aware, indications of possible misuse of a shell company in the account history, or changes in address or signatories on the account. As some financial institutions currently update CIP information at periodic intervals based on risk or when updating other customer information as part of routine account maintenance, financial institutions may consider updating beneficial ownership information on a similar basis. Each financial institution's policies and procedures should be based on its assessment of risk and tailored to, among other things, its customer base and products and services offered. In addition, financial institutions should update beneficial ownership information in connection with ongoing monitoring, as described below in the Section III.d "Ongoing Monitoring."

8. Reliance

Some comments requested that FinCEN extend the reliance provisions in the CIP rules to the beneficial ownership requirement. In general, a financial institution may rely upon another financial institution to conduct CIP with respect to shared customers,

provided that: (i) such reliance is reasonable; (ii) the other financial institution is subject to an AML program rule and is regulated by a federal functional regulator, and (iii) the other financial institution enters into a contract and provides annual certifications regarding its AML program and CIP requirements.⁴⁶ Similarly, FinCEN proposes to permit such reliance for purposes of complying with the beneficial ownership requirement, including obtaining the certification form required under the proposed rule. Existing guidance with respect to whether a financial institution can rely on another financial institution to conduct CIP with respect to shared customers also would apply for the purposes of complying with the beneficial ownership requirement.⁴⁷ As was the case with the CIP rules, a covered financial institution will not be held responsible for the failure of the relied-upon financial institution to adequately fulfill the covered financial institution's beneficial ownership responsibilities, provided it can establish that its reliance was reasonable and that it has obtained the requisite contracts and certifications.

C. UNDERSTANDING THE NATURE AND PURPOSE OF CUSTOMER RELATIONSHIPS

The third element of CDD requires financial institutions to understand the nature and purpose of customer relationships in order to develop a customer risk profile.⁴⁸ Many comments questioned whether such information is helpful for detecting suspicious activity, and expressed concern that financial institutions would be required to

⁴⁶ See, e.g., 31 CFR 1020.220(a)(6).

⁴⁷ See, e.g., CFTC letter No. 05-05 (March 14, 2005) (FCMs and IBs are permitted to rely on CTAs to conduct CIP in certain circumstances).

⁴⁸ The ANPRM characterized this third element as “understand[ing] the nature and purpose of the account and expected activity associated with the account for the purpose of assessing the risk and identifying and reporting suspicious activity.” 77 FR 13050.

demonstrate compliance by formalizing this element in their policies and procedures. They suggest that it should not become a required question that must be asked of each customer during the account opening process, so long as it is understood by the financial institution.

FinCEN understands that it is industry practice to gain an understanding of a customer in order to assess the risk associated with that customer to help inform when the customer's activity might be considered "suspicious." FinCEN does not intend for this element to necessarily require modifications to existing practice or customer onboarding procedures, and does not expect financial institutions to ask each customer for a statement as to the nature and purpose of the relationship or to collect information not already collected pursuant to existing requirements. Rather, the amendment to the AML program rule that incorporates this element is intended to clarify existing expectations for financial institutions to understand the relationship for purposes of identifying transactions in which the customer would not normally be expected to engage. Identifying such transactions is a critical and necessary aspect of complying with the existing requirement to report suspicious activity and maintain an effective AML program.

FinCEN intends for this amendment to be consistent with existing rules and related guidance. For example, the requirement for financial institutions to report suspicious activity requires that they file a report on a transaction that, among other things, has "no business or apparent lawful purpose or is not the sort in which the

particular customer would normally be expected to engage.”⁴⁹ In the context of depository institutions, it is well understood that “a bank should obtain information at account opening sufficient to develop an understanding of normal and expected activity for the customer’s occupation or business operations.”⁵⁰ This is also true in other contexts.⁵¹ FinCEN intends for this proposed CDD element to be consistent with these types of expectations.

FinCEN believes that in some circumstances an understanding of the nature and purpose of a customer relationship can also be developed by inherent or self-evident information about the product or customer type, or basic information about the customer. FinCEN recognizes that inherent information about a customer relationship, such as the type of customer, the type of account opened, or the service or product offered, may be sufficient to understand the nature and purpose of the relationship. Obtaining basic information about the customer, such as annual income, net worth, domicile, or principal occupation or business, may similarly be relevant depending on the facts and circumstances.⁵² In addition, longstanding customers of a financial institution may have a robust history of activity that could also be highly relevant in understanding future

⁴⁹ 31 CFR 1020.320(a)(2)(iii); see also §§ 1023.320(a)(2)(iii), 1024.320(a)(2)(iii), and 1026.320(a)(2)(iii).

⁵⁰ BSA/AML Manual at *64.

⁵¹ See, e.g., CFTC Regulation 1.37(a)(1) and NFA Compliance Rule 2-30 which require futures commission merchants and introducing brokers to obtain certain information from individuals and other unsophisticated customers during the onboarding process and to verify annually whether the information continues to be materially accurate. Although these requirements are intended to address the inherent risks of trading futures and the need for adequate risk disclosure, this information could be relevant for understanding the nature and purpose of such customer relationships.

⁵² The BSA/AML Manual also notes that an understanding of normal and expected activity for the customer’s occupation or business operations may be “based on account type or customer classification.” BSA/AML Manual at 64.

expected activity for purposes of detecting aberrations. At the same time, FinCEN recognizes that certain financial institutions, such as securities and futures firms, often maintain accounts in which expected activity can vary significantly over time based on numerous factors, and that prior transaction history or information obtained from the client upon account opening may not be a reliable indicator of future conduct. Each case depends on the facts and circumstances unique to the financial institution and its customers.

Accordingly, FinCEN believes that financial institutions should already be satisfying this element by complying with the requirement to report suspicious activity, as this element is an essential step in the process of identifying such activity. In addition, because this is a necessary step to identifying and reporting suspicious activities, which obligation applies to all “transactions...conducted or attempted by, at or through” the covered financial institution, its scope should not be limited to “customers” for purposes of the CIP rules, but rather should extend more broadly to encompass all accounts established by the institution.⁵³

D. ONGOING MONITORING

The fourth element of CDD requires financial institutions to conduct ongoing monitoring for the purpose of maintaining and updating customer information and identifying and reporting suspicious activity.⁵⁴ As with the third element, FinCEN

⁵³ See, e.g., 31 CFR 1020.100(a) and (c), which note that the definitions, and exemptions, for account and customer apply in the context of CIP. Within the context of CDD, “customer relationship” is a broader term, not subject to the exemptions referenced in definitions used for CIP.

⁵⁴ By comparison, the ANPRM suggested that “consistent with its suspicious activity reporting requirements, covered financial institutions shall establish and maintain appropriate policies, procedures, and processes for conducting on-going monitoring of all customer relationships, and additional CDD as

intends for this element to be consistent with a financial institution's current suspicious activity reporting⁵⁵ and AML program requirements. A financial institution required to have an AML program must, among other things, develop internal policies, procedures and controls to assure compliance with the BSA,⁵⁶ including the SAR requirements. As a practical matter, compliance with these obligations implicitly requires financial institutions to conduct ongoing monitoring. The BSA/AML Manual notes that the internal controls of a bank's AML Program should "provide sufficient controls and monitoring systems for timely detection and reporting of suspicious activity."⁵⁷ Similarly, under rules promulgated by the Financial Industry Regulatory Authority (FINRA), a broker-dealer's AML program shall include policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder.⁵⁸ Codifying these supervisory and regulatory expectations as explicit requirements within FinCEN's AML program requirements is necessary to make clear that the minimum standards of CDD include ongoing monitoring of all transactions by, at, or through the financial institution.

appropriate based on such monitoring for the purpose of the identification and reporting of suspicious activity." 77 FR 13053.

⁵⁵ Under the suspicious activity reporting rules, a financial institution must report, among other things, a transaction that: (i) involves funds derived from illegal activity or is conducted to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade any federal law or regulation or to avoid any federal transaction reporting requirement; (ii) is designed to evade any requirements of the BSA or its implementing regulations; or (iii) has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction. 31 CFR 1020.320(a)(2)(i)–(iii); 31 CFR 1023.320(a)(2)(i)–(iii); 31 CFR 1024.320(a)(2)(i)–(iii); 31 CFR 1026.320(a)(2)(i)–(iii).

⁵⁶ See, e.g., 31 U.S.C. 5318(h)(1); 12 U.S.C. 1818(s)(1); 31 CFR 1020.210.

⁵⁷ BSA/AML Manual at 33-34.

⁵⁸ FINRA Rule 3310.

Some commenters expressed confusion as to whether this fourth element would impose a categorical requirement to periodically update, or “refresh,” customer information that was obtained during the account opening process, including beneficial ownership information. This element does not impose such a categorical requirement. Rather, the requirement that the financial institution “conduct ongoing monitoring to maintain and update customer information” means that, when in the course of monitoring the financial institution becomes aware of information relevant to assessing the risk posed by a customer, it is expected to update the customer’s relevant information accordingly.⁵⁹ FinCEN understands that industry practice generally involves using activity data to inform what types of transactions might be considered “normal” or “suspicious.” Furthermore, FinCEN understands that information that might result from monitoring could be relevant to the assessment of risk posed by a particular customer. The proposed requirement to update a customer’s profile as a result of ongoing monitoring (including obtaining beneficial ownership information for existing customers on a risk basis), is different and distinct from a categorical requirement to update or refresh the information received from the customer at the outset of the account relationship at prescribed periods, as was noted in the discussion of existing customers set forth in Section III.b of this proposal.

Because financial institutions are already implicitly required to engage in ongoing monitoring, FinCEN expects that financial institutions would satisfy the fourth element of CDD by continuing their current monitoring practices, consistent with existing guidance

⁵⁹ See, e.g., BSA/AML Manual at 64 (“CDD processes should include periodic risk-based monitoring of the customer relationship to determine whether there are substantive changes to the original CDD information (e.g., change in employment or business operations).”).

and regulatory expectations.⁶⁰ FinCEN reiterates that all elements of CDD discussed in this proposal are minimum standards and should not be interpreted or construed as lowering, reducing or limiting the expectations established by the appropriate federal functional regulator. Finally, as noted above with respect to the obligation to understand the nature and purpose of customer relationships, monitoring is also a necessary element of detecting and reporting suspicious activities, and as such must apply not only to “customers” for purposes of the CIP rules, but more broadly to all account relationships maintained by the covered financial institution.

E. RULE TIMING AND EFFECTIVE DATE

Financial institutions have requested sufficient time to implement any new CDD requirements. Specifically, to manage costs, financial institutions requested sufficient time to incorporate these requirements into cyclical updates of their systems and processes. FinCEN believes that the two CDD requirements set forth in this proposal will not in fact require covered financial institutions to perform any additional activities or operations, although it may necessitate revisions to written policies and procedures. FinCEN also recognizes that financial institutions will be required to modify existing customer onboarding processes to incorporate the beneficial ownership requirement, and therefore proposes an effective date of one year from the date the final rule is issued.

IV. **SECTION –BY-SECTION ANALYSIS**

A. BENEFICIAL OWNERSHIP INFORMATION COLLECTION

Section 1010.230 Beneficial Ownership Requirements for Legal Entity Customers

⁶⁰ See, e.g., BSA/AML Manual at 67-85 (“Suspicious Activity Reporting – Overview”); NFA’s Interpretive Notice accompanying NFA Compliance Rule 2-9 (FCMs and IBs must train appropriate staff to monitor cash activity and trading activity in order to detect unusual transactions).

Section 1010.230(a) General. This section sets forth the general requirement for covered financial institutions to identify the beneficial owners of each legal entity customer (as defined).

Section 1010.230(b) Identification and Verification. In order to identify the beneficial owner, a covered financial institution must obtain a certification from the individual opening the account on behalf of the legal entity customer (at the time of account opening) in the form of Appendix A. The form requires the individual opening the account on behalf of the legal entity customer to identify the beneficial owner(s) of the legal entity customer by providing the beneficial owner's name, date of birth, address and social security number (for U.S. persons).⁶¹ This information is consistent with the information required under the CIP rules for identifying customers that are natural persons. The form also requires the individual opening the account on behalf of the legal entity customer to certify, to the best of his or her knowledge, that the information provided on the form is complete and correct. Obtaining a signed and completed form from the individual opening the account on behalf of the legal entity customer shall satisfy the requirement to identify the beneficial owners under Section 1010.230(a).

This section also requires financial institutions to verify the identity of the individuals identified as beneficial owners on the certification form. The procedures for verification are to be identical to the procedures applicable to an individual opening an account under the existing CIP rules. Accordingly, the financial institution must verify a beneficial owner's identity using the information provided on the certification form

⁶¹ For foreign persons, the form requires a passport number and country of issuance, or other similar identification number.

(name, date of birth, address, and social security number (for U.S. persons), etc.), according to the same documentary and non-documentary methods the financial institution may use in connection with its customer identification program (to the extent applicable to customers that are individuals), within a reasonable time after the account is opened. A financial institution must also include procedures for responding to circumstances in which it cannot form a reasonable belief that it knows the true identity of the beneficial owner, as described under the CIP rules.⁶²

Section 1010.230(c) Beneficial Owner. As more fully described above, the proposed definition of “beneficial owner” includes two independent prongs: an ownership prong (clause (1)) and a control prong (clause (2)). A covered financial institution must identify each individual under the ownership prong (i.e., each individual who owns 25 percent or more of the equity interests), in addition to one individual for the control prong (i.e., any individual with significant managerial control). If no individual owns 25 percent or more of the equity interests, then the financial institution may identify a beneficial owner under the control prong only. If appropriate, the same individual(s) may be identified under both criteria.

Section 1010.230(d) Legal Entity Customer. For purposes of the beneficial ownership requirement described under this Section, the proposed rule defines “legal entity customer” to mean a corporation, limited liability company, partnership or similar business entity (whether formed under the laws of a state or of the United States or a

⁶² See, e.g., 31 CFR 1020.220(a)(2)(iii). Such procedures must address (a) when it should not open an account; (b) the terms under which the customer may use the account while the institution attempts to verify the identity of the beneficial owner; (c) when the institution should close the account, after attempts to verify the beneficial owner’s identity have failed; and (d) when it should file a SAR.

foreign jurisdiction), that opens a new account. The reference to “new account” makes clear that the obligation to identify beneficial owners under Section 1010.230 applies to legal entity customers opening new accounts after the date of rule’s implementation, and not retrospectively. Previously issued guidance that clarifies who a customer is under certain circumstances shall be instructive to the extent applicable to the proposed beneficial ownership requirement.⁶³

Section 1010.230(e) Covered financial Institution. This term has the meaning set forth in 31 CFR 1010.605(e)(1), which defines the term for purposes of the regulations implementing Sect 312 of the PATRIOT Act.

Section 1010.230(f) Retention of Records. A financial institution must have procedures for maintaining a record of all information obtained in connection with identifying and verifying the beneficial owners under 1010.230(b). These procedures must include retaining the beneficial ownership certification form, and any other related identifying information collected, for a period of five years after the date the account is closed. It must also retain in its records, for a period of five years after such record is made, a description of (i) every document relied on for verification, (ii) any non-documentary methods and results of measures undertaken for verification, and (iii) the resolution of any substantive discrepancies discovered in verifying the identification information. The proposed rule leverages off of industry familiarity with the recordkeeping requirements relative to identifying and verifying the identity of individual

⁶³ See, e.g., Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act at Question 9 (April 28, 2005), *available at* http://www.fincen.gov/statutes_regs/guidance/html/fagsfinalciprule.html; Guidance from the Staffs of the Department of the Treasury and the U.S. Securities and Exchange Commission, *Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule (31 CFR 103.122)* (October 1, 2003), *available at* http://www.fincen.gov/statutes_regs/guidance/html/20031001.html.

customers under the CIP rules, and proposes an identical recordkeeping standard here. This is with the understanding that identical standards will help relieve implementation burden with respect to the new requirement.

Section 1010.230(g) Reliance on Another Financial Institution. The proposed rule permits reliance on another financial institution under the same conditions set forth in the applicable CIP rules.⁶⁴

B. AMENDMENTS TO AML PROGRAM REQUIREMENTS

Overview

FinCEN's existing AML program requirements applicable to each type of covered financial institution are being amended to ensure alignment between existing AML requirements and CDD minimum standards. As described in Section III above, CDD consists of four fundamental components. The first component, customer identification, is already sufficiently included in the existing Customer Identification Program requirements issued jointly by FinCEN and its regulatory colleagues. The second component, identification of the beneficial ownership of legal entity customers, is proposed as a separate rule in 31 CFR 1010.230, as outlined above. The third and fourth components of CDD – understanding the nature and purpose of an account and ongoing monitoring – which have been understood as necessary facets of other regulatory requirements, are now being explicitly included in applicable AML program rules, as described in more detail below. Covered financial institutions are expected to apply these procedures on a risk-based approach with respect to the breadth of their account relationships, consistent with their obligation to identify and report suspicious activities.

⁶⁴ See, e.g., 31 CFR 1020.220(a)(6).

FinCEN is incorporating these CDD procedures into the AML program requirements to make clear that CDD is a core element of a financial institution's policies and procedures to guard against money laundering. Furthermore, incorporating these CDD requirements into the AML program requirements, which require the AML program to also comply with the regulation of its federal functional regulator governing such programs, makes clear that a financial institution's procedures with respect to these requirements are subject to examination and enforcement by the appropriate federal functional regulator or self-regulatory organization in a manner consistent with current supervisory authorities and expectations. As such, this proposed rule is not intended to limit the federal functional regulators' supervisory role or, where applicable, its ability to oversee an SRO's effective examination and enforcement of BSA compliance.

Nothing in this proposal is intended to lower, reduce, or limit the due diligence expectations of the federal functional regulators or in any way limit their existing regulatory discretion. To clarify this point, this proposal incorporates the CDD elements on nature and purpose and ongoing monitoring into FinCEN's existing AML program requirements, which generally provide that an AML program is adequate if, among other things, the program complies with the regulation of its federal functional regulator (or, where applicable, self-regulatory organization) governing such programs.⁶⁵ In addition, the Treasury Department intends for the requirements contained in this customer due diligence and beneficial ownership proposal to be consistent with, and not to supersede,

⁶⁵ See, e.g., 31 CFR 1020.210, which currently provides: "A financial institution regulated by a Federal functional regulator that is not subject to the regulations of a self-regulatory organization shall be deemed to satisfy the requirements of 31 U.S.C. 5318(h)(1) if it implements and maintains an anti-money laundering program that complies with . . . *the regulation of its Federal functional regulator governing such programs.*" (emphasis added).

any regulations, guidance or authority of any federal banking agency, the SEC, the CFTC, or of any SRO relating to customer identification, including with respect to the verification of the identities of legal entity customers.

The FinCEN AML Program rules (for banks, securities broker-dealers, mutual funds, and futures commission merchants and introducing brokers in commodities) are also being amended to ensure that FinCEN's regulations explicitly include the existing core requirements that are currently included within the AML program rules issued by the federal functional regulators or their appointed self-regulatory organizations (SROs). These existing core pillars, referenced in 31 U.S.C. 5318(h) as "minimum" requirements, include: (i) the development of internal policies, procedures and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit program to test functions. While there are slight differences in the wording of the regulatory requirements across the rules applicable to each industry, FinCEN considers them to all be the same in practice at their core. FinCEN sees utility for industry in having these rules clearly spelled out in FinCEN's own regulations and believes that there is further utility in making these rules more uniform, particularly given the number of industry actors that have constituent components subject to multiple rules. FinCEN also acknowledges, however, that the core requirements set forth by SROs, as approved by the federal functional regulator supervising them, sometimes include details deemed warranted with respect to the SROs' oversight of those industries. While such detail may not be included in FinCEN's rules, FinCEN and the supervising regulator have coordinated in the past to ensure that such rules are consistent with the purposes of the

BSA. There is no intent in this rulemaking to undermine the nuances that currently exist with respect to those rules, and they can be followed in tandem with rules set forth here.

Section 1020.210 Anti-money Laundering Program requirements for financial institutions regulated by a Federal functional regulator, including banks, savings associations and credit unions.

FinCEN is rewriting its existing AML program rule to include the existing core provisions already included in regulations issued by the relevant banking agencies and adding to these core provisions a fifth pillar that includes the components of CDD pertaining to understanding the nature and purpose of customer relationships and ongoing monitoring, as discussed above.

Section 1023.210 Anti-money laundering program requirements for brokers or dealers in securities

FinCEN is rewriting its AML program rule for brokers or dealers in securities to include the existing core requirements already applicable to the industry and adding to these core provisions a new pillar that includes the components of CDD pertaining to understanding the nature and purpose of customer relationships and ongoing monitoring, as discussed above.

FinCEN notes that its proposed AML program rule for brokers or dealers differs from the current program rule issued by FINRA. This is chiefly because FINRA has included as a pillar within its AML program rule a requirement with respect to suspicious activity reporting. This is different from the rules issued with respect to other sectors where the SAR requirement has been treated separately. FinCEN is not proposing to incorporate, as FINRA has done, a SAR reporting requirement as a separate pillar, as the existing stand-alone SAR rule within FinCEN's regulations is sufficient. However, the decision to not include this within the pillars of the FinCEN rule is not meant to affect its

treatment within the FINRA rule. FinCEN sees no practical difference in effect as a result of this difference and is proposing its amendments to the FinCEN AML program rule for brokers or dealers in securities in a manner that is consistent with its other AML program rules. FinCEN will continue to engage with the SEC and FINRA to determine whether there is a need for, and how, the FinCEN and FINRA provisions might be made more consistent with respect to this particular structural difference in the regulations.

Section 1024.210 Anti-money laundering program requirements for mutual funds

FinCEN is maintaining its existing AML program rule for mutual funds with the addition to the core requirements of a fifth pillar that includes the components of CDD pertaining to understanding the nature and purpose of customer relationships and ongoing monitoring, as discussed above.

Section 1026.210 Anti-money laundering program requirements for futures commission merchants and introducing brokers in commodities

FinCEN is rewriting its AML program rule for futures commission merchants and introducing brokers to include the existing core requirements already applicable to the industry and adding to these core provisions a fifth pillar that includes the components of CDD pertaining to understanding the nature and purpose of customer relationships and ongoing monitoring, as discussed above.

V. REQUEST FOR COMMENTS

FinCEN invites comments on all aspects of the NPRM, and specifically seeks comments on the following issues:

Definition of Beneficial Owner:

FinCEN seeks general comments on the proposed definition of beneficial owner, including the inclusion of two prongs, and whether each prong is sufficiently clear.

FinCEN seeks comment specifically on whether the term “equity interests” in the ownership prong of the proposed beneficial ownership definition will be sufficiently understood and clear to financial institutions and customers.

Definition of Legal Entity Customer:

FinCEN seeks comment on the proposed definition of legal entity customer, and in particular whether it provides adequate clarity.

Existing Accounts

FinCEN seeks comment as to whether FinCEN should extend the proposed requirement on covered financial institutions to collect beneficial ownership information so that it would apply retroactively with respect to legal entity accounts established before the implementation date of a final rule as well as comment on the potential costs of such an expansion of the rule.

Proposed Exemptions from the Beneficial Ownership Rule:

FinCEN seeks comment on the proposed exemptions from the definition of “legal entity customer,” including whether the exemptions are appropriate, whether other exemptions should be included, and if so, what exemptions.

Intermediated Accounts:

FinCEN seeks comment on whether the proposed treatment of intermediated accounts in general is sufficiently clear to address any issues that may be expected to arise.

Pooled Investment Vehicles:

FinCEN seeks comment specifically on whether pooled investment vehicles that are not proposed to be exempt from the beneficial ownership requirement but are

operated or advised by financial institutions that are proposed to be exempt, should also be exempt from the beneficial ownership requirement, and if not, whether covered financial institutions should be required to identify beneficial owners of such non-exempt pooled investment vehicles under only the control prong of the “beneficial owner” definition, as opposed to both the ownership prong and control prong.

Trusts:

FinCEN seeks comment on procedures used by financial institutions to collect and record information on trusts during their CDD process and whether that information is readily searchable and retrievable and accessible to law enforcement. FinCEN seeks comment from law enforcement regarding the accessibility of information regarding trusts when sought from financial institutions and the value of such information.

Certification Form:

FinCEN seeks comment on the proposed certification form and the practical ability of financial institutions to incorporate the form into their account opening processes. Further, while FinCEN believes that requiring all legal entity customers to complete the same form is useful in promoting clarity and consistency across the financial industry, FinCEN seeks comment on whether financial institutions should be permitted to obtain the same information that the form requires (including the certification from the individual opening the account on behalf of the legal entity customer) through other means, such as an automated electronic account opening process.

Verification of Beneficial Owners:

FinCEN seeks comment on whether requiring financial institutions to utilize existing CIP procedures for verification of the identity of beneficial owners is sufficiently clear and is an appropriate and efficient means for achieving this objective.

Updating of Beneficial Ownership Information:

FinCEN seeks comment as to whether setting a mandated timeframe for the updating of beneficial ownership information would result in better information being available on beneficial ownership than relying on financial institutions to update the information in due course, consistent with the risk-based approach.

Recordkeeping Requirements:

FinCEN seeks comment as to whether requiring recordkeeping procedures identical to those required with respect to CIP recordkeeping requirements is a sufficiently clear and efficient standard in the context of beneficial ownership verification information collection.

Understanding the nature and purpose of customer relationships and ongoing monitoring:

FinCEN seeks comment on whether the proposed requirements regarding understanding the nature and purpose of customer relationships and ongoing monitoring are sufficiently clear. In this regard, should FinCEN define any of the terms used in those proposed requirements to clarify that such requirements apply broadly to all account relationships maintained by covered financial institutions? Should FinCEN define the term “customer risk profile,” or is this term sufficiently understood by covered financial institutions? FinCEN also seeks comment from industry as to whether there are any covered financial institutions that have been able to meet the existing AML program

requirements and SAR requirements without understanding the nature and purpose of customer relationships and conducting ongoing monitoring.

Proposed Amendments to the AML Program Rules:

FinCEN seeks industry comment as to whether industry feels that it is necessary for the language of each AML program pillar requirement to be identical across FinCEN's rules; and, whether there is a need for FinCEN's rules and those of its sister organizations to be identical, notwithstanding FinCEN's belief that the core pillars are essentially the same across various industries despite any differences in legacy regulatory text. Based on industry feedback, FinCEN will weigh the benefits of possibly finalizing the program rules so that currently existing wording differences with respect to each pillar may be reduced.

Effective Date of the Rule:

FinCEN seeks comment on whether the proposed effective date of one year from the date of the issuance of the final rule is sufficient to enable financial institutions to work any necessary changes into their systems or procedures in tandem with other cyclical updates, and thereby enable financial institutions to reduce implementation costs.

VI. REGULATORY ANALYSIS

A. EXECUTIVE ORDERS 13563 AND 12866

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of

harmonizing rules, and of promoting flexibility. This rule has been designated a “significant regulatory action” although not economically significant, under section 3(f) of Executive Order 12866. Accordingly, the rule has been reviewed by the Office of Management and Budget.

FinCEN has determined that the primary cost for covered financial institutions associated with the proposed rule results from the requirement that they obtain from their non-exempt legal entity customers a certification identifying their beneficial owners. FinCEN has not been able to obtain from any source an estimate of the total number of accounts opened annually for legal entities by covered financial institutions. Based on outreach and discussions with major financial service companies, FinCEN believes that there are approximately eight million such accounts opened annually by covered financial institutions. Based on the total number of covered financial institutions,⁶⁶ this would result in each covered financial institution opening approximately 368 such accounts per year, or 1.5 per day.⁶⁷ Estimating an average time for a covered financial institution to receive the certification and verify the information of 20 minutes and an average cost of \$20 per hour, this results in a cost of approximately \$54 million.⁶⁸

Estimating the amount of illicit funds flow facilitated through legal entities used to mask beneficial ownership would be difficult.⁶⁹ However, the benefit of the rule will be greater clarity with respect to a regulatory definition of beneficial ownership and a

⁶⁶ See “Paperwork Reduction Act (PRA),” “Estimated Number of Respondents,” *infra* note 81

⁶⁷ FinCEN also believes that the largest covered financial institutions likely open far more such accounts per day than the smaller institutions.

⁶⁸ See PRA, “Estimated Reporting Burden,” *infra*. This includes the cost of one hour per covered financial institution to develop new beneficial ownership procedures.

⁶⁹ For one general discussion of the difficulty of deriving estimates of money laundering activity in narcotrafficking and other transactional criminal activity, see “Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crimes,” United Nations Office on Drugs and Crime (October 2011).

greater percentage of situations in which this information will be collected, as appropriate, by the covered financial institutions, and, therefore, available to law enforcement. Based on a survey conducted in 2008, FinCEN determined that perhaps as little as one third of its private sector constituents felt that they had a clear understanding of the term beneficial ownership and that significant percentages varying across industries did not collect information on beneficial ownership consistently. Since the issuance of that survey, further engagement with industry via the issuance of interagency guidance⁷⁰ and FinCEN's ANPRM provided opportunities for greater common understanding of the issues, but questions remain.

FinCEN believes that with the clarity of a regulatory definition and a clear requirement to collect beneficial ownership in specific situations, industry understanding of beneficial ownership and the collection of beneficial ownership information will increase, and that the increased availability of such information to law enforcement will enhance government efforts to identify and address illicit actors operating in the financial system through legal entities. FinCEN requests comment on the benefits, and any estimates of costs savings, associated with a requirement to collect beneficial ownership information, including any economic or statistical data or third-party/independent research.

REGULATORY FLEXIBILITY ACT

When an agency issues a rule proposal, the Regulatory Flexibility Act (RFA) requires the agency to either provide an Initial Regulatory Flexibility Analysis or, in lieu

⁷⁰ See footnote 15.

of preparing an analysis, to certify that the proposed rule is not expected to have a significant economic impact on a substantial number of small entities.⁷¹

Estimate of the number of small entities to which the proposed rule will apply:

This proposed rulemaking will apply to all federally regulated depository institutions and trust companies, and all brokers or dealers in securities, mutual funds, and futures commission merchants and introducing brokers, as each is defined in the BSA. Based upon current data, for the purposes of the RFA, there are approximately 5470 small federally regulated banks (comprising 80% of the total number of banks);⁷² 47 small federally regulated trust companies (comprising 72% of the total);⁷³ 4,325 small federally regulated credit unions (comprising 66% of the total),⁷⁴ 871 small brokers or dealers in securities (comprising 17% of the total);⁷⁵ 116 small mutual funds (comprising 7% of the total);⁷⁶ no small futures commission merchants;⁷⁷ and 1,186 small introducing

⁷¹ 5 U.S.C. 601-612.

⁷² The Small Business Administration (“SBA”) defines a depository institution other than a credit union as a small business if it has assets of \$500 million or less. Based on publicly available information as of December 31, 2013 there are 6,821 federally regulated depository institutions (other than credit unions) of which approximately 5,470, or 80% are categorized as small businesses.

⁷³ The SBA defines a trust company as a small business if it has assets of \$35.5 million or less. Based on publicly available information as of September 30, 2013, there are 65 federally regulated trust companies, of which 47, or 72%, are categorized as small businesses.

⁷⁴ The NCUA defines small credit unions as those having under \$50 million in assets. As of December 31 2013, there were 6554 federally regulated credit unions.

⁷⁵ With regard to the definition of small entity as it applies to broker dealers in securities and mutual funds, FinCEN is using the SEC’s definitions found at 17 CFR 240.0-10(c), and 17 CFR 270.0-10, respectively. Of the 5,100 brokers or dealers in securities, 871 or 17% are categorized as a small business.

⁷⁶ Of the 1,660 open-end mutual funds, 116 or 7% are categorized as a small business.

⁷⁷ The CFTC has determined that futures commission merchants are not small entities for purposes of the RFA, and, thus, the requirements of the RFA do not apply to them. The CFTC's determination was based, in part, upon the obligation of futures commission merchants to meet the minimum financial requirements

brokers (comprising 95% of the total). Because the proposed rule would apply to all of these financial institutions, FinCEN concludes that the proposed rule will apply to a substantial number of small entities.

Description of the projected reporting, recordkeeping, and other requirements of the proposed rule: This proposed rulemaking imposes on all covered financial institutions (including those that are small entities) a new requirement to identify and to verify the identity of the beneficial owners of their legal entity customers. The proposed rule would require that this be accomplished by obtaining and maintaining a certification from each legal entity customer that opens a new account. The certification will contain identifying information regarding each listed beneficial owner. The financial institution will also be required to verify such identity by documentary or non-documentary methods and to maintain in its records for five years a description of (i) any document relied on for verification, (ii) any non-documentary methods and results of measures undertaken, and (iii) the resolution of any substantive discrepancies discovered in verifying the identification information.

Although FinCEN has only limited available information to assess the average number of beneficial owners of legal entity customers for which accounts may be established after the effective date of the rule, FinCEN notes that the maximum number is five, and believes that it is reasonable to assume that the great majority of such customers who establish accounts at small institutions are more likely to have simpler ownership structures that will result in one or two beneficial owners. In addition, since all covered

established by the CFTC to enhance the protection of customers' segregated funds and protect the financial condition of futures commission merchants generally. Small introducing brokers in commodities are defined by the SBA as those having less than \$7 million in gross receipts annually. Of the 1,249 introducing brokers in commodities, 1,186 or 95% are categorized as a small business.

financial institutions have been subject to CIP rules for more than ten years, and the proposal utilizes CIP rule procedures, small institutions will be able to leverage these procedures in complying with this requirement. As a result, FinCEN believes that it is reasonable to estimate that it will require, on average, 20 minutes to perform the beneficial ownership identification, verification and recordkeeping requirements in the proposal. Furthermore, FinCEN has anecdotal evidence that in general, the customers of small institutions are primarily individuals and that they do not frequently establish accounts for legal entities, which would also reduce the impact of the proposed requirement on small entities.⁷⁸ However, because statistical data does not exist regarding either the average number of beneficial owners of legal entity customers of small institutions or how many such accounts they establish in any time period, FinCEN is seeking comment on these questions.

The proposed rule would also require that covered financial institutions include in their AML programs, customer due diligence procedures, including understanding the nature and purpose of customer relationships and conducting ongoing monitoring of these relationships. Because these requirements are already a part of existing AML and SAR practices, they will not impose any new obligations, and therefore will have no economic impact, on any small entities.

Finally, the proposed rule would require each covered financial institution to amend its AML program to include the new requirement contained in the proposal, to

⁷⁸ FinCEN notes that, while its estimate of the aggregate burden on industry resulting from the beneficial ownership requirement is based on an average of 1.5 legal entity accounts per day for each institution (see “Executive Orders 13563 and 12866” *supra*), it understands from its outreach that large institutions likely open hundreds or even thousands such accounts per day, while small institutions likely open, on average, far fewer than 1.5 such accounts per day.

train its employees regarding the new requirement, and to update its data systems to include the beneficial ownership information. FinCEN understands from its outreach that in general, most covered financial institutions, including those that are small entities, periodically update their AML programs, conduct AML training, and upgrade their IT systems. FinCEN also understands that most small institutions outsource their IT requirements and so would acquire the required updated program from a vendor. FinCEN intends to extend the implementation date for the proposed rule for one year from issuance for the purpose of enabling financial institutions to integrate these new program, training and data collection requirements into their cyclical updates with minimal additional cost.

Consideration of Significant Alternatives: The proposed rule would apply to all covered financial institutions. FinCEN has determined that identifying the beneficial owner of a financial institution's legal entity customers and verifying that identity is a necessary part of an effective AML program. FinCEN has not identified any alternative means for obtaining this information, other than imposing this as a requirement for opening new legal entity accounts for all covered financial institutions. Were FinCEN to exempt small entities from this requirement, those entities would be potentially more subject to abuse by money launderers and other financial criminals.

Certification: The additional burden proposed by the rule would be a requirement to maintain an AML program that includes collection and verification of beneficial owner information. It would also require financial institutions, large and small, to update their AML programs, train relevant employees, and modify data collection systems. As discussed above, FinCEN estimates that the impact from this requirement would not be

significant. Accordingly, FinCEN certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities.

Questions for comment: Please provide comment on any or all of the provisions of the proposed rule with regard to their economic impact on small entities (including costs and benefits), and what less burdensome alternatives, if any, FinCEN should consider. In particular, FinCEN is seeking comment on the economic burden associated with the proposed beneficial ownership requirement, including the number of new accounts opened for legal entities by small covered financial institutions and the estimated time that would be required to comply with the proposed requirements for the identification and verification of the beneficial owners of such new legal entity customers, as well as the costs associated with the program updates and necessary training and IT system modifications.

B. PAPERWORK REDUCTION ACT

The new recordkeeping requirement contained in this proposed rule (31 CFR 1010.230) is being submitted to the Office of Management and Budget (OMB) for review in accordance with the Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501 *et seq.*, which imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. Under the PRA, an agency may not conduct or sponsor, and an individual is not required to respond to, a collection of information unless it displays a valid OMB control number. Comments concerning the estimated burden and other questions should be sent to the Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506),

Washington, D.C. 20503 with a copy to FinCEN by mail. Comments may also be submitted by e-mail to oira_submission@omb.eop.gov. Please submit comments by one method only. Comments are welcome and must be received by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

In summary, the proposed rule would require covered financial institutions to maintain records of the information used to identify and verify the identity of the names of the beneficial owners of legal entity customers.⁷⁹

Type of Review: Initial review of the proposed information collection elements of the “Certification of Beneficial Owner(s)” in support of the beneficial ownership requirements for financial institutions.⁸⁰

Affected public: Businesses or other for-profit and not-for-profit entities, and certain financial institutions.

OMB Control Number: 1506-00XX.

Frequency: As required.

Estimated Reporting Burden:

- a. Develop and maintain beneficial ownership identification procedures: 1 hour.⁸¹
- b. Customer identification, verification, and review and recordkeeping of the “Certification of Beneficial Owner(s)”: 20 minutes per financial institution.

⁷⁹ This requirement applies to accounts established for legal entities. A legal entity generally includes a corporation, limited liability company, partnership, or any other similar business entity formed in the United States or a foreign country.

⁸⁰ A copy of the proposed certification, which would be required by 31 CFR 1010.230, appears at the end of this notice.

⁸¹ A burden of one hour to develop the initial procedures is recognized. Once developed, an annual burden of twenty minutes is recognized for maintenance.

Estimated number of respondents: 21,550.⁸²

Estimated Total Annual Responses: 8,081,250.⁸³

Estimated Recordkeeping and Reporting Burden: 2,715,300 hours.⁸⁴

The numbers presented assume that the number of account openings in 2013 is representative for an average yearly establishment of accounts for new legal entities.

Records are required to be retained pursuant to the beneficial ownership requirement for five years.

Request for Comments:

Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record.

Comments are invited on: (i) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (ii) the accuracy of the agency's estimate of the burden of the collection of information; (iii) ways to enhance the quality, utility, and clarity of the information to be collected; (iv) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; (v) the reasonableness of the estimated number of new annual account openings for legal entities; and (vi)

⁸² This includes depository institutions (13,375), trust companies (65), broker-dealers in securities (5,100), future commission merchants (101), introducing brokers in commodities (1,249), and open-end mutual funds (1,660), each as defined under the BSA. These figures represent the total number of entities that would be subject to the proposed requirements in this notice.

⁸³ Based on initial research, each covered financial institution will open, on average, 1.5 new legal entity accounts per business day. There are 250 business days per year.

⁸⁴ $8,081,250 \times 20 \text{ minutes per account established} \div 60 \text{ minutes per hour} = 2,693,750 \text{ hours plus development time of } 21,550 \text{ hours for a total of } 2,715,300 \text{ hours the first year.}$

estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

C. UNFUNDED MANDATES ACT OF 1995 STATEMENT

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. FinCEN has determined that this proposed rule will not result in expenditures by state, local, and tribal governments, or by the private sector, of \$100 million or more. Accordingly, FinCEN has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

List of Subjects in 31 CFR Parts 1010, 1020, 1023, 1024, and 1026

Administrative practice and procedure, Banks, Banking, Brokers, Currency, Federal home loan banks, Foreign banking, Foreign currencies, Gambling, Investigations, Mortgages, Penalties, Reporting and recordkeeping requirements, Securities, Terrorism.

Authority and Issuance

For the reasons set forth in the preamble, Chapter X of Title 31 of the Code of Federal Regulations is proposed to be amended as follows:

PART 1010 – GENERAL PROVISIONS

1. The authority citation for part 1010 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

2. Add § 1010.230 in subpart B to read as follows:

§1010.230 Beneficial ownership requirements for legal entity customers.

- (a) *In general.* Covered financial institutions are required to establish and maintain written procedures that are reasonably designed to identify and verify beneficial owners of legal entity customers.
- (b) *Identification and verification.* With respect to legal entity customers, the covered financial institution's customer due diligence procedures should enable the institution to:
 - (1) Identify the beneficial owner(s) of each legal entity customer, unless otherwise exempt pursuant to paragraph (d) of this section. To identify the beneficial owner(s), a covered financial institution must obtain at the time a new account is opened a certification in the form of Appendix A of this section from the individual opening the account on behalf of the legal entity customer; and
 - (2) Verify the identity of each beneficial owner identified to the covered financial institution, according to risk-based procedures to the extent reasonable and practicable. At a minimum, these procedures must be identical to the covered financial institution's Customer Identification Program procedures required for verifying the identity of customers that are individuals

under §1020.220(a)(2) of this chapter (for banks); §1023.220(a)(2) of this chapter (for brokers or dealers in securities); §1024.220(a)(2) of this chapter (for mutual funds); or §1026.220(a)(2) of this chapter (for futures commission merchants or introducing brokers in commodities).

(c) *Beneficial owner*. For purposes of this section, Beneficial Owner means each of the following:

- (1) Each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25% or more of the equity interests of a legal entity customer;
- (2) A single individual with significant responsibility to control, manage, or direct a legal entity customer, including
 - (i) An executive officer or senior manager (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, or Treasurer); or
 - (ii) Any other individual who regularly performs similar functions.

Note to paragraph (c): The number of individuals that satisfy the definition of “beneficial owner,” and therefore must be identified and verified pursuant to this section, may vary.

Under paragraph (c)(1) of this section, depending on the factual circumstances, up to four individuals may need to be identified. Under paragraph (c)(2) of this section, only one individual must be identified. It is possible that in some circumstances the same person or persons might be identified pursuant to paragraphs (c)(1) and (2) of this section. A covered financial institution may also identify additional individuals as part of its customer due diligence if it deems appropriate on the basis of risk.

(d) *Legal entity customer.* For the purposes of this section,

- (1) *Legal entity customer* means: a corporation, limited liability company, partnership or other similar business entity (whether formed under the laws of a state or of the United States or a foreign jurisdiction) that opens a new account.
- (2) *Legal entity customer* does not include:
 - (i) A financial institution regulated by a Federal functional regulator or a bank regulated by a State bank regulator;
 - (ii) A person described in § 1020.315(b)(2) through (5) of this chapter;
 - (iii) An issuer of a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that is required to file reports under section 15(d) of that Act;

- (iv) An investment company, as defined in section 3 of the Investment Company Act of 1940, that is registered with the Securities and Exchange Commission under that Act;
- (v) An investment adviser, as defined in section 202(a)(11) of the Investment Advisers Act of 1940, that is registered with the Securities and Exchange Commission under that Act;
- (vi) An exchange or clearing agency, as defined in section 3 of the Securities Exchange Act of 1934, that is registered under section 6 or 17A of the Securities Exchange Act of that Act;
- (vii) Any other entity registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934;
- (viii) A registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, each as defined in section 1a of the Commodity Exchange Act, that is registered with the Commodity Futures Trading Commission;
- (ix) A public accounting firm registered under section 102 of the Sarbanes–Oxley Act; and
- (x) A charity or nonprofit entity that is described in sections 501(c), 527, or 4947(a)(1) of the Internal Revenue Code of 1986, has not been denied tax exempt status, and is

required to and has filed the most recently due annual information return with the Internal Revenue Service.

(e) *Covered financial institution.* For the purposes of this section, covered financial institution has the meaning set forth in § 1010.605(e)(1).

(f) *Recordkeeping.* A covered financial institution must establish procedures for making and maintaining a record of all information obtained under the procedures implementing paragraph (b) of this section.

(1) *Required records.* At a minimum the record must include:

- (i) For identification, the certification form described in paragraph (b) of this section, and any other identifying information obtained by the covered financial institution; and
- (ii) For verification, a description of any document relied on (noting the type, any identification number, place of issuance and; if any, date of issuance and expiration), of any non-documentary methods and the results of any measures undertaken, and of the resolution of each substantive discrepancy.

(2) *Retention of records.* A covered financial institution must retain the records made under paragraph (f)(1)(i) of this section for five years after the date the account is closed, and the

records made under paragraph (f)(1)(ii) of this section for five years after the record is made.

(g) *Reliance on another financial institution.* A covered financial institution may rely on the performance by another financial institution (including an affiliate) of the requirements of this section with respect to any legal entity customer of the covered financial institution that is opening, or has opened, an account or has established a similar business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions, provided that:

- (1) Such reliance is reasonable under the circumstances;
- (2) The other financial institution is subject to a rule implementing 31 U.S.C. 5318(h) and is regulated by a Federal functional regulator; and
- (3) The other financial institution enters into a contract requiring it to certify annually to the covered financial institution that it has implemented its anti-money laundering program, and that it will perform (or its agent will perform) the specified requirements of the covered financial institution's procedures to comply with the requirements of this section.

APPENDIX A-- CERTIFICATION REGARDING BENEFICIAL OWNERS OF LEGAL ENTITY CUSTOMERS

I. GENERAL INSTRUCTIONS

What is this form?

To help the government fight financial crime, federal regulation requires certain financial institutions to obtain, verify, and record information about the beneficial owners of legal entity customers. Legal entities can be abused to disguise involvement in terrorist financing, money

laundering, tax evasion, corruption, fraud, and other financial crimes. Requiring the disclosure of key individuals who ultimately own or control a legal entity (i.e., the beneficial owners) helps law enforcement investigate and prosecute these crimes.

Who has to complete this form?

This form must be completed by the person opening a new account on behalf of a legal entity with any of the following U.S. financial institutions: (i) a bank or credit union; (ii) a broker or dealer in securities; (iii) a mutual fund; (iv) a futures commission merchant; or (v) an introducing broker in commodities.

For the purposes of this form, a **legal entity** includes a corporation, limited liability company, partnership, and any other similar business entity formed in the United States or a foreign country.

What information do I have to provide?

This form requires you to provide the name, address, date of birth and social security number (or passport number or other similar information, in the case of foreign persons) for the following individuals (i.e., the **beneficial owners**):

- (i) Each individual, if any, who owns, directly or indirectly, 25 percent or more of the equity interests of the legal entity customer (e.g., each natural person that owns 25 percent or more of the shares of a corporation); **and**
- (ii) An individual with significant responsibility for managing the legal entity customer (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President or Treasurer).

The financial institution may also ask to see a copy of a driver's license or other identifying document for each beneficial owner listed on this form.

II. CERTIFICATION OF BENEFICIAL OWNER(S)

Persons opening an account on behalf of a legal entity must provide the following information:

a. *Name of Person Opening Account:*

b. *Name of Legal Entity for Which the Account is Being Opened:*

c. *The following information for each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of the legal entity listed above:*

(If no individual meets this definition, please write "Not Applicable.")

Name	Date of Birth	Address	<i>For U.S. Persons: Social Security Number</i>	<i>For Foreign Persons: Passport Number and Country of Issuance, or other similar identification number¹</i>

d. *The following information for one individual with significant responsibility for managing the legal entity listed above, such as:*

- An executive officer or senior manager (e.g., Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, Treasurer); or*
- Any other individual who regularly performs similar functions.*

(If appropriate, an individual listed under section (c) above may also be listed in this section (d)).

Name	Date of Birth	Address	<i>For U.S. Persons: Social Security Number</i>	<i>For Foreign Persons: Passport Number and Country of Issuance, or other similar identification number¹</i>

I, _____ (name of person opening account), hereby certify, to the best of my knowledge, that the information provided above is complete and correct.

Signature: _____ Date: _____

¹ In lieu of a passport number, foreign persons may also provide an alien identification card number, or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

PART 1020-RULES FOR BANKS

3. The authority citation for part 1020 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

4. Revise § 1020.210 in subpart B to read as follows:

§1020.210 Anti-money laundering program requirements for financial institutions regulated only by a Federal functional regulator, including banks, savings associations, and credit unions.

A financial institution regulated by a Federal functional regulator that is not subject to the regulations of a self-regulatory organization shall be deemed to satisfy the requirements of 31 U.S.C. 5318(h)(1) if the financial institution implements and maintains an anti-money laundering program that:

(a) Complies with the requirements of §§ 1010.610 and 1010.620 of this chapter;

(b) Includes, at a minimum:

(1) A system of internal controls to assure ongoing compliance;

(2) Independent testing for compliance to be conducted by bank personnel or by an outside party;

(3) Designation of an individual or individuals responsible for coordinating and monitoring day-to-day compliance;

(4) Training for appropriate personnel; and

(5) Appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:

(i) Understanding the nature and purpose of customer

relationships for the purpose of developing a customer risk profile; and

(ii) Conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions; and

(c) Complies with the regulation of its Federal functional regulator governing such programs.

PART 1023-RULES FOR BROKERS OR DEALERS IN SECURITIES

5. The authority citation for part 1023 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

6. Revise § 1023.210 in subpart B to read as follows:

§1023.210 Anti-money laundering program requirements for brokers or dealers in securities.

A broker or dealer in securities shall be deemed to satisfy the requirements of 31 U.S.C. 5318(h)(1) if the broker-dealer implements and maintains a written anti-money laundering program approved by senior management that:

(a) Complies with the requirements of §§ 1010.610 and 1010.620 of this chapter and any applicable regulation of its Federal functional regulator governing the establishment and implementation of anti-money laundering programs;

(b) Includes, at a minimum:

(1) The establishment and implementation of policies, procedures, and internal controls reasonably designed to achieve compliance with the

applicable provisions of the Bank Secrecy Act and the implementing regulations thereunder;

- (2) Independent testing for compliance to be conducted by the broker-dealer's personnel or by a qualified outside party;
- (3) Designation of an individual or individuals responsible for implementing and monitoring the operations and internal controls of the program;
- (4) Ongoing training for appropriate persons; and
- (5) Appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:
 - (i) Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and
 - (ii) Conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions; and
- (c) Complies with the rules, regulations, or requirements of its self-regulatory organization governing such programs; provided that the rules, regulations, or requirements of the self-regulatory organization governing such programs have been made effective under the Securities Exchange Act of 1934 by the appropriate Federal functional regulator in consultation with FinCEN.

PART 1024-RULES FOR MUTUAL FUNDS

7. The authority citation for part 1024 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

8. Revise § 1024.210 in subpart B to read as follows:

§1024.210 Anti-money laundering program requirements for mutual funds.

(a) Effective July 24, 2002, each mutual fund shall develop and implement a written anti-money laundering program reasonably designed to prevent the mutual fund from being used for money laundering or the financing of terrorist activities and to achieve and monitor compliance with the applicable requirements of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*), and the implementing regulations promulgated thereunder by the Department of the Treasury. Each mutual fund's anti-money laundering program must be approved in writing by its board of directors or trustees. A mutual fund shall make its anti-money laundering program available for inspection by the U. S. Securities and Exchange Commission.

(b) The anti-money laundering program shall at a minimum:

- (1) Establish and implement policies, procedures, and internal controls reasonably designed to prevent the mutual fund from being used for money laundering or the financing of terrorist activities and to achieve compliance with the applicable provisions of the Bank Secrecy Act and implementing regulations thereunder;
- (2) Provide for independent testing for compliance to be conducted by the mutual fund's personnel or by a qualified outside party;
- (3) Designate a person or persons responsible for implementing and

- monitoring the operations and internal controls of the program;
- (4) Provide ongoing training for appropriate personnel; and
- (5) Implement appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:
 - (i) Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and
 - (ii) conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions.

PART 1026-RULES FOR FUTURES COMMISSION MERCHANTS AND
INTRODUCING BROKERS IN COMMODITIES

9. The authority citation for part 1026 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

10. Revise § 1026.210 in subpart B to read as follows:

§1026.210 Anti-money laundering program requirements for futures commission merchants and introducing brokers in commodities.

A futures commission merchant and an introducing broker in commodities shall be deemed to satisfy the requirements of 31 U.S.C. 5318(h)(1) if the futures commission merchant or introducing broker in commodities implements and maintains a written anti-money laundering program approved by senior management that:

- (a) Complies with the requirements of §§ 1010.610 and 1010.620 of this chapter

and any applicable regulation of its Federal functional regulator governing the establishment and implementation of anti-money laundering programs;

(b) Includes, at a minimum:

- (1) The establishment and implementation of policies, procedures, and internal controls reasonably designed to prevent the financial institution from being used for money laundering or the financing of terrorist activities and to achieve compliance with the applicable provisions of the Bank Secrecy Act and the implementing regulations thereunder;
- (2) Independent testing for compliance to be conducted by the futures commission merchant or introducing broker in commodities' personnel or by a qualified outside party;
- (3) Designation of an individual or individuals responsible for implementing and monitoring the operations and internal controls of the program;
- (4) Ongoing training for appropriate persons;
- (5) Appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:
 - (i) Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and
 - (ii) Conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious

transactions; and

- (c) Complies with the rules, regulations, or requirements of its self-regulatory organization governing such programs; provided that the rules, regulations, or requirements of the self-regulatory organization governing such programs have been made effective under the Commodity Exchange Act by the appropriate Federal functional regulator in consultation with FinCEN.

Dated: July 23, 2014.

Jennifer Shasky Calvery,
Director, Financial Crimes Enforcement Network.

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